Petition

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

MESA PETROLEUM CO.,
Petitioner,

v.

THE KANSAS POWER AND LIGHT COMPANY, INC.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE KANSAS SUPREME COURT

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QUESTION PRESENTED

Whether Section 105(b)(1) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3315, precludes operation of contractually established price escalation clauses in intrastate gas contracts and freezes prices to those in effect on the date of enactment of the Natural Gas Policy Act.

OTHER PARTIES

State Corporation Commission of the State of Kansas

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THE KANSAS POWER AND LIGHT COMPANY, INC.,
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PETITION FOR A WRIT OF CERTIORARI TO THE KANSAS SUPREME COURT

The Petitioner, MESA PETROLEUM CO., prays that a writ of certiorari issue to review the opinions and judgments of the Kansas Supreme Court in the above entitled cases on July 17, 1981.

OPINIONS BELOW

The opinions of the Kansas Supreme Court are not yet reported, and appear at Appendices E and F. The opinion of the Kansas Supreme Court on Mesa Petroleum Co.'s Motion for Rehearing is not yet reported, and appears at Appendix H. The Journal Entries of Judgment of the various District Courts are unpublished, and appear at Appendices B and D.

JURISDICTION

The Opinion on Motion for Rehearing was rendered by the Kansas Supreme Court on July 17, 1981. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

STATUTE AND REGULATION INVOLVED

Section 105(b)(1) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3315, provides:

> (b) MAXIMUM LAWFUL PRICE.—
>
> (1) GENERAL RULES.—Subject to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of—
>
> (A) The price under the terms of the existing contract, to which such natural gas was subject on the date of the enactment of this Act, as such contract was in effect on such date; or
>
> (B) The maximum lawful price, per million Btu's, computed for such month under Section 102 (relating to new natural gas).

Regulations of the Federal Energy Regulatory Commission implementing Section 105(b)(1) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3315, provide:

> (a) *November 9, 1978 contract price at or below $2.060 per MMBtu.* In the case of a first sale of natural gas to which this subpart applies (other than a first sale to which paragraph (b) applies) [paragraph (b) applies if the November 9, 1978 contract price is greater than $2.060 per MMBtu], the maximum lawful price

for natural gas delivered in any month shall be the lower of:

(1) The price for such month under the terms of the existing intrastate contract to which such natural gas was subject on November 9, 1978, as such contract was in effect on November 9, 1978; or

(2) The maximum lawful price per MMBtu for such month specified for new natural gas (Subpart B of Part 271) in Table I of § 271.101(a).[1]

STATEMENT OF THE CASE

A. Introduction

The instant case involves the proper construction of Section 105(b)(1) of the Natural Gas Policy Act of 1978[2] ("NGPA"). Specifically, Petitioner seeks to have this Court review decisions of the Kansas Supreme Court that construe Section 105(b)(1) as precluding the operation of contractually authorized price escalation clauses in intrastate gas contracts, thereby freezing prices to those in effect on the date of enactment of the NGPA.

B. Facts

In 1976, the Petitioner, Mesa Petroleum Co. ("Mesa"), and the Respondent, The Kansas Power and Light Company, Inc. ("KPL"), entered into a Supplemental Contract for the sale of intrastate natural gas produced from Grant County, Kansas. Although the Supplemental Contract contained various price escalation provisions, the pertinent provision for this litigation is Article I(b). Article I(b) of the Supplemental Contract provides:

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[1] 18 C.F.R. § 271.502(a) (1980).

[2] 15 U.S.C. §§ 3301-3432.

> *Governmental Price Regulations:* If the Federal Power Commission or any successor governmental authority, having jurisdiction in the premises shall at any time hereafter prescribe by law, rate proceeding, rulemaking procedure or a comparable procedure any price applicable to any natural gas of any vintage produced from the Hugoton-Anadarko area and sold intrastate in Kansas or in interstate commerce, which is higher than the price or prices then provided in this Article I to be paid for New Gas delivered hereunder, then the price to be paid for New Gas remaining to be sold hereunder shall be increased to equal such regulated price. In that event, the increased price shall become effective as of the date of action of the governmental or regulatory authority establishing the regulated price, or its effective date, whichever is later (subject to the provisions of paragraph (e) below, and shall remain in effect until later changed in accordance with the pricing provisions of this Agreement.

The NGPA was enacted on November 9, 1978, and became effective December 1, 1978. On November 9, 1978, the contract price under the Supplemental Contract was $1.92 per Mcf,[3] and the maximum lawful price under the contract accordingly was governed by Section 105(b)(1) of the NGPA. Section 105(b)(1) of the NGPA regulates the sale of natural gas under existing intrastate contracts where the contract price on the date of enactment of the NGPA (November 9, 1978) was less than or equal to $2.06 per MMBtu. This section provides that

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[3] The term "Mcf," when used with respect to natural gas means 1000 cubic feet of gas. The term is a measurement of volume. The term "MMBtu," when used with respect to natural gas, means 1,000,000 British thermal units. MMBtu's measure energy. Typically, as a standard for gas measurement, 1 Mcf of gas contains 1,000,000 British thermal units, thus 1 Mcf equals 1 MMBtu. Accordingly, a contract price of $1.92 per Mcf is lower than a contract price of $2.06 per MMBtu, and for purposes of this litigation, Mcf's and MMBtu's can be used interchangeably.

the maximum lawful price will be the lower of the price under the terms of the existing contract or the price established by Section 102 of the NGPA.

It was and is Mesa's contention that as a result of the passage of the NGPA, the contract price escalated under Article I(b) of the Supplemental Contract to the Section 102 ceiling price on December 1, 1978 (the effective date of the NGPA). When KPL failed to pay the increased prices authorized by the Supplemental Contract, as a result of the passage of the NGPA, Mesa instituted suit in the District Court of Grant County, Kansas asking for a declaratory judgment that Mesa properly terminated the Supplemental Contract. The District Court ruled that the contractual language was clear and unambiguous, and reflected the intent of Mesa and KPL to establish the maximum price allowed by the Federal Government (i.e. the Section 102 ceiling price) as the contract price through the operation of the contract language.[4] However, the District Court interpreted Section 105(b)(1) of the NGPA as applied to the Supplemental Contract as preventing escalation of the contract price.[5] As a result, Mesas' prayer for a declaratory judgment was denied.

Mesa also filed suit against KPL in Meade and Clark Counties, Kansas, alleging that KPL had breached other contracts containing language substantially similar to Article I(b) of the Supplemental Contract by failing to pay the higher rates established under the NGPA. The

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[4] App. A at 3a. This holding would allow the Supplemental Contract to escalate to the Section 102 price if it were an interstate contract subject to the jurisdiction of the Federal Energy Regulatory Commission. See Orders issued in Federal Energy Regulatory Commission Docket No. RM79-22, Order No. 23 and amendments and clarifications thereto.

[5] App. A at 3a-4a.

Meade and Clark County cases were consolidated, and the District Court held against Mesa.[6]

On appeal, the Kansas Supreme Court in separate opinions affirmed both of the District Court judgments. The principal opinion came in the Grant County litigation. The Supreme Court agreed with the finding that the parties intended the price under the Supplemental Contract to escalate to the maximum price allowed by the Federal Government,[7] and that Mesa was entitled to the relief sought if the price did escalate.[8] Like the trial court, however, the Supreme Court found the parties' intent had been thwarted by the operation of Section 105(b)(1):

> The maximum lawful price under Section 105(b)(1) was either the price under the terms of the existing contract on November 9, 1978 ($1.92 per Mcf), or the maximum price under Section 102 of the N.G.P. Act for the month of December, 1978 ($2.078 per million BTU's), whichever is lower. Clearly the contract price on November 9, 1978, is the lower and will remain the maximum lawful price under Section 105(b)(1).
>
> . . .
>
> The contract by its terms does not provide for price escalation upon enactment of the N.G.P. Act on November 9, but only on December 1. Price escalation on December 1, however, is no escalation at all for the maximum ceiling price can only rise to the lower of the two prices. The contract price on November 9 was the lower at $1.92 per Mcf.[9]

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[6] App. C.

[7] App. E at 34a.

[8] App. E at 33a.

[9] App. E at 35a-36a.

In affirming the other District Court decision, the Supreme Court in a *per curiam* opinion noted the facts were similar and

> [m]ost importantly, the escalator clauses in the Clark and Meade County contracts are identical to the escalator clause in the Grant County case in all significant respects. In the Grant County case we have this day held that the price escalator clause was not triggered by the establishment of maximum prices in the Natural Gas Policy Act of 1978 (15 U.S.C. § 3301 *et seq.* [1979]), and Mesa's attempted termination was therefore ineffectual. This determination is dispositive of the appeal herein and we do not reach the other issues raised.[10]

Mesa then filed a Motion for Rehearing with the Kansas Supreme Court [11] pointing out that the Court's interpretation of Section 105(b)(1) would prohibit any escalation in price which would occur subsequent to November 9, 1978, and that three weeks earlier the United States Court of Appeals for the Fifth Circuit in *Pennzoil v. Federal Energy Regulatory Commission*,[12] had construed Section 105(b)(1) in the manner urged by Mesa. Eight natural gas producing companies as well as the Kansas Independent Oil & Gas Association filed briefs *amicus curiae* with the court in support of Mesa's Motion for Rehearing. The Kansas Supreme Court denied the motion and issued an Opinion on the Motion for Rehearing which clarified its earlier opinion. In the short clarifying opinion the Kansas Supreme Court stated:

> As we interpret the N.G.P. Act it does not preclude escalation of prices under contract clauses up to

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[10] App. F at 38a.

[11] Mesa's Motion for Rehearing is reprinted at Appendix G.

[12] 645 F.2d 360 (May 20, 1981), *petition for certiorari* filed August 18, 1981, No. 81-340, U.S.L. Week 33133 (1981).

> N.G.P. Act ceiling prices. On the other hand, contrary to the assumption of Mesa, the mere enactment of the N.G.P. Act did not activate price escalation clauses, such as the one in the present case, so as to escalate prices to the N.G.P. Act ceiling level.
>
> We adhere to our original decision that the price of gas under the terms of the contract between the parties did not escalate to the N.G.P. Act ceiling price merely because the N.G.P. Act was passed and became law.[13]

That very day the Court underscored its adherence to its original interpretation of Section 105(b)(1) when it interpreted an escalation clause in *Energy Resources Group v. KPL.*[14] It noted that (as with the Mesa-KPL contract) escalation would occur on the later of November 9 or December 1. Then it quoted Section 105(b)(1). Applying Section 105(b)(1) to the ERG-KPL contracts, it wrote: "We hold that under the terms of the government price escalator clause in these contracts, and under the applicable section of the NGPA, the November 9th gas price (which was lower than the Section 102 price) did not escalate. The rationale expressed in the *Mesa Petroleum Company* case is fully applicable here." [15]

I. THE OPINION BELOW CONFLICTS WITH A DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT AND WITH THE INTERPRETATION OF THE FEDERAL ENERGY REGULATORY COMMISSION.

The Kansas Supreme Court has construed Section 105(b)(1) as prohibiting escalations under intrastate contracts if they occur subsequent to November 9, 1978.

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[13] App. H at 55a-56a.

[14] —— Kan. —— (1981) [Reprinted at Appendix J].

[15] *Id.* at ——, App. J at 71a.

This construction of Section 105(b)(1) is a result of the Court's confusion in interpreting the phrase "the price under the terms of the existing contract . . . as such contract was in effect on such date" as meaning the same thing as "the contract price on November 9, 1978." The Court stated:

> The maximum lawful price under Section 105(b)(1) was either *the price under the terms of the existing contract on November 9, 1978 ($1.92 per mcf)*,[16] or the maximum price under Section 102 of the N.G.P. Act for the month of December, 1978 ($2.078 per million Btu's), whichever is lower. Clearly the contract price on November 9, 1978 is the lower and remains the maximum lawful price under Section 105(b)(1).[17] (Emphasis supplied)

Applying this erroneous interpretation to the actual contractual provisions involved in this litigation, the Kansas Supreme Court accordingly determined:

> The contract by its terms does not provide for price escalation upon enactment of the N.G.P. Act on November 9, but only on December 1. Price escalation on December 1, however, is no escalation at all for the maximum ceiling price can only rise to the lower of the two prices. The contract price on November 9, was the lower at $1.92 per mcf.[18]

In the related *Energy Reserves Group* case which was rendered on the same date as the decision on rehearing on this case, the Kansas Supreme Court reaffirmed the basis for its decision below by holding as follows:

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[16] Petitioner's "contract price" on November 9, 1978 was $1.92 per Mcf. However, as will be subsequently established, the underlined language from Section 105(b)(1)(A) refers to the contract terms (i.e. the words used in defining the contractual obligation) which were in effect on November 9, 1978, not the November 9, 1978 contract price.

[17] App. E at 35a.

[18] App. E at 36a.

> The final sentence of Section 6.7 of ERG-KPL contracts provide that "[i]n that event [that a governmental authority fixes a higher price] the increased price shall be effective as of the date of action of the governmental or regulatory authority establishing the regulated price [November 9, 1978], or its effective date [December 1, 1978], *whichever is later. . . .*" (Emphasis supplied) The November 9th price, then, continued until December 1, 1978, under the clear terms of the contracts.
>
> Section 105(b)(1) of the NGPA fixes the maximum lawful price of intrastate gas as the lower of the Section 102 price or "the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date . . ." We hold that under the terms of the government price escalator clause in these contracts, and under the applicable section of the NGPA, the November 9th gas price (which was lower than the Section 102 price) did not escalate. The rationale expressed in the *Mesa Petroleum Company* case is fully applicable here. The NGPA did not trigger a price increase because the contracts herein did not contain a sufficient escalation mechanism.[19] (Emphasis and insertions in original)

The decision below effectively nullifies the purpose and intent of Section 105(b)(1) by prohibiting *any* contractual escalations which are intended to take place subsequent to November 9, 1978. The result is based on the following chain of reasoning: (1) the maximum lawful price is the *lower* of "the price under the terms of the contract" or the Section 102 price (a correct statement); (2) "the price under the terms of the contract" is the November 9, 1978 contract price (an incorrect statement); therefore, (3) if the November 9, 1978 price is lower than the Section 102 price, then the November 9, 1978 price will control. Yet by definition the Novem-

[19] App. J at 71a.

ber 9, 1978 price must be lower or equal to the Section 102 price or else Section 105(b)(1) will not apply.[20] And if the November 9, 1978 price is lower, then under the Court's interpretation of Section 105(b)(1), the November 9, 1978 price will remain immutably fixed as the maximum price under the contract because it will always be lower than the Section 102 price.[21] Thus, the interpretation below is that regardless of the parties' intent,[22] federal law will preclude price escalation. The decision below freezes the November 9, 1978 contract price for as long as the NGPA is in existence.

Congress did not intend such a result, and both the Federal Energy Regulatory Commission ("FERC") and the Court of Appeals for the Fifth Circuit have rendered opinions directly conflicting with the interpretation of the Kansas Supreme Court. The Fifth Circuit decision was *Pennzoil v. FERC*.[23] The difference between the Fifth Circuit's view and the view of the Kansas Supreme Court concerning the freezing of the November 9 price and of possible contract price escalation from the November 9 price could not be clearer. *Pennzoil* states:

> Under Section 105(b)(1) . . . the maximum lawful price is the lower of the Section 102 price or the

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[20] If the November 9, 1978 contract price is above the Section 102 price, Section 105(b)(2) must control. 15 U.S.C. § 3315(b)(2).

[21] This point is further illustrated in the next section of the Reasons for Granting the Writ and in footnote "31" *infra*.

[22] The Court below affirmed a trial court finding "that the parties intended that if Congress increased the maximum prices for which gas sold that this would fulfill the reference in Article I(b) to action by any successor governmental agency." (App. E at 34a.)

[23] 645 F.2d 360 (May 20, 1981, *petition for certiorari* filed August 18, 1981, No. 81-340, 50 U.S.L. Week 33133 (1981)). Although the Fifth Circuit in *Pennzoil* discussed the proper operation of Section 105(b)(1), the QUESTION PRESENTED in this case is not raised in the petition for certiorari filed in *Pennzoil*.

> current price under the existing intrastate contract (*rather than the November 9th price*). If the contract has an escalation provision, definite or indefinite, it may authorize collection of prices up to but not in excess of the Section 102 price. . . .[24] (Emphasis supplied)

The error in interpretation by the Kansas Supreme Court is further illustrated by the following analysis from *Pennzoil:*

> If . . . the price on November 9th was less than section 102, under section 105(b)(1) the maximum lawful price is the current price provided for under the terms of the contract as long as it does not exceed the section 102 price. Therefore . . . the intrastate contract price may escalate from its November 9th level to the section 102 level, provided that the contract has a sufficient escalation mechanism. . . .
>
> Congress thus codified intrastate prices existing on November 9th if higher than section 102, but codified the "contract schedule of prices or contract mechanism for establishing prices *over time*" subject to the cap of section 102 if the November 9th price was less than section 102. 124 Cong. Rec. H13117 (daily ed. Oct. 14, 1978) (statement of Rep. Dingell) (Emphasis in original). This elaborate incorporation of either the contract price or the contract escalation provisions into the maximum lawful price would have been totally unnecessary if section 101(b)(9) froze existing, November 9th contract prices.[25]

In addition to conflicting with the *Pennzoil* decision, the decision below also conflicts with the FERC's regulations implementing Section 105(b)(1) of the NGPA. The FERC regulations provide:

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[24] *Id.* at 376.

[25] *Id.* at 374-75.

> . . . [T]he maximum lawful price for natural gas delivered in any month shall be the lower of:
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> (1) the price for such month under the terms of the existing intrastate contract to which such natural gas was subject on November 9, 1978, as such contract was in effect on November 9, 1978; or
>
> (2) the maximum lawful price per MMBtu for such month specified for new natural gas (Subpart B of Part 271) in table I of § 271.101(a) [26]

These regulations were implemented only after some initial confusion caused by the FERC's incorrect usage of the term "contract price" in place of the term "price under the terms of the contract." The error brought forth an immediate response and the FERC corrected the error, noting:

> Comments were received from various parties concerning our use of the phrase "contract price" in § 271.502(a)(1). They asserted that its use in that paragraph caused confusion as to whether future contractually authorized fixed or indefinite price escalator clauses, including price redetermination provisions, operate to effect price increases. The commentors fear that an interpretation more restrictive than required by the legislation would apply in the case of § 271.502(a)(1). One commentor therefore suggested that § 271.501(a)(1) be revised to track the statutory language in section 105(b)(1)(A) of the NGPA to refer to the "price under the terms of the existing contract." We agree and we have revised § 271.502(a)(1) to track the appropriate statutory language. This change should allay the apprehensions of those commentors who

[26] 18 C.F.R. 271.502(a) (1980).

feared that fixed or indefinite price escalator clauses in contracts were abrogated by § 271.502(a)(1).[27]

The FERC's regulations thus provide that the contract price may escalate in accordance with contract terms, subject to the cap established by the Section 102 price. These regulations are perfectly consistent with the provisions of the NGPA and the Fifth Circuit determination in *Pennzoil*. They are also wholly inconsistent with the determination below.

II. THE DECISION BELOW IS DIRECTLY CONTRARY TO THE CONGRESSIONAL POLICY ESTABLISHED BY THE NGPA.

As Petitioner has demonstrated, the decision below rests on a construction of Section 105(b)(1) as if it said "the price on [November 9] under the terms of the contract" rather than what the section actually says, "the price under the terms of the existing contract [on November 9] . . . as such contract was in effect." In so construing the section the Kansas Supreme Court ignored the Congressional purpose in placing the time limitation in Section 105(b)(1). The date of enactment was placed in Section 105(b)(1) for a specific purpose: to prevent subsequent modifications of contracts to authorize higher prices. Congress was not, however, adverse to all higher prices. It intended that agreements reached prior to the date of enactment should remain in place and the parties be able to rely on their bargain subject only to the price ceiling of Section 102. This interpretation was explicitly set forth by the House and Senate Managers in their explanation that the purpose of Section 105(b)(1) was to allow a preexisting pricing mechanism under a contract to take place sub-

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[27] Federal Energy Regulatory Commission, Interim Regulations Implementing the Natural Gas Policy Act of 1978, 43 F.R. 56448, CCH Vol. II, Paragraph 30,062, at 30,162 (December 1, 1978).

sequent to November 9 so long as it did not exceed the Section 102 price:

> The maximum lawful price [under Section 105] depends upon the contract price in effect on the date of enactment of this Act. If the contract price in effect on the date of enactment is less than the new gas ceiling price, the maximum lawful price for any subsequent month is the lower of (1) the price under the terms of the existing contract in effect on the date of enactment, or (2) the new gas price. *Thus, the price under the contract may escalate through the operation of both fixed price escalator clauses and indefinite price escalator clauses in existence as of the date of enactment, but the price may not exceed the new gas price.*[28] (Emphasis supplied)

Congressman Dingell made a similar explanation of the operation of Section 105(b)(1) when he stated:

> The ceiling price mechanism under Section 105(b)(1) is based upon "the terms of the existing contract . . . in effect on [date of enactment of the NGPA]." This phrase must be distinguished from the phrase "contract price" used in Section 105(b)(2). The latter is date specific, referring to the price paid under the contract for gas deliveries on date of enactment. The phrase "the price under the terms of the . . . contract" used in Section 105(b)(1) refers to the contract schedule of prices or contract mechanism for establishing prices *over time.* [Emphasis in original] This schedule or mechanism is given effect with the single limitation that the price so established may not exceed the new gas ceiling price established under Section 102. *The contract price terms in effect on date of enactment would then be honored up to the new gas ceiling price.*[29] (Emphasis supplied)

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[28] H.R. Rep. No. 95-1752, 95th Cong., 2d Sess. 82 (1978).

[29] 124 Cong. Rec. H13117 (daily ed. Oct. 14, 1978).

The Fifth Circuit in *Pennzoil* followed these statements in its conclusion that a contract may escalate according to its terms subject only to the limitations of Section 102. The Kansas Supreme Court, however, interpreted Section 105(b)(1) so that a contractually authorized schedule of price increases cannot occur subsequent to November 9, 1978 in any contract subject to Section 105(b)(1). A hypothetical example using (for ease of understanding only) a contract with a fixed escalator clause will illustrate the error of the interpretation below.[30] Assume there is an existing intrastate contract that on November 9, 1978 has a contract price of $.50 per MMBtu. Assume further that the only escalation provided for in the contract is a fixed escalator clause that provided for a $.25 per MMBtu escalation per year, effective upon the first day of each calendar year. Under the interpretation below of Section 105(b)(1), the following would occur. First, the "contract price" as of November 9 would be $.50 per MMBtu. Second, since the Court mistakenly construes "contract price" on November 9 as being the same as the "price under the terms of the contract," the lower of the "price under the terms of the contract" and the Section 102 price would be $.50 per MMBtu. Accordingly, the contract price would be immutably fixed at $.50 per MMBtu for so long as the NGPA remained in effect. This result would follow regardless of the fact that there were fixed, definite price increases due the seller each year, increases that would not cause the contract price to exceed the Section 102 price.

The hypothetical illustrates that under the decision below prenegotiated price escalator clauses are rendered in-

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[30] At footnote "31" *infra*, a slightly different hypothetical is offered.

operative.[31] In Kansas not only are parties prevented from amending their contracts to provide for higher prices (by Congress), they are prevented from relying on specific rate increases established in their contracts (by the mistaken interpretation of Section 105(b)(1)). Outside of Kansas the hypothetical would be handled as follows. On the first day of the next calendar year the price would escalate to $.75 per MMBtu. On the first day of the subsequent calendar year, the price would escalate to $1.00 per MMBtu. And so on. The only limitation established by Section 105(b)(1) is that the price received by the seller not exceed the Section 102 price.

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[31] The hypothetical also assists in illustrating the confusion of the Kansas Supreme Court. The Court has repeatedly stated that under the NGPA price escalations are not nullified and yet the Court does not realize that its interpretation of Section 105(b)(1) prevents their operation. As a further illustration, take the sentence from the next to the last paragraph in the Opinion denying the Motion for Rehearing: "In our present case, the contract as drawn by the parties did not provide for payment of the highest price allowed by law and this Court will not rewrite the contract to authorize that result." Suppose the price escalator in the Supplemental Contract said explicitly that the "price shall escalate to the Section 102 price of the Natural Gas Policy Act of 1978 (i.e., the highest price allowed by law)." On November 9, 1978 the contract price was $1.92 Mcf. Now, quoting from the Court's original Opinion: 'The maximum lawful price under Section 105(b)(1) was either the price under the terms of the existing contract on November 9, 1978 ($1.92 per Mcf), or the maximum price under Section 102 of the N.G.P. Act for the month of December, 1978 ($2.078 per MMBtu's) whichever is lower. Clearly the contract price on November 9, 1978 is the lower and will remain the maximum lawful price under Section 105(b)(1)." Thus even with a contract escalation provision that specifically calls for escalation to prices allowed by the NGPA, the Kansas Supreme Court's interpretation of Section 105(b)(1) would prevent the contract from escalating. The simple fact is that the Kansas Supreme Court is in error when it says price escalation is possible under its interpretation of Section 105(b)(1). Thinking it possible does not make it possible.

This interpretation of the hypothetical contract and the escalation clause comports with Congressional intent, FERC regulations, and the *Pennzoil* analysis. In an opinion citing neither Congressional statements nor FERC regulations, the Kansas Supreme Court dissents. Its mistaken interpretation of the NGPA can only be corrected by this Court.

CONCLUSION

Federal law cannot mean one thing in Texas and Louisiana and another in Kansas. Once a contract is interpreted [32] the governing law applied must be uniform.

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[32] Petitioner agrees with both the FERC and the Fifth Circuit in *Pennzoil* that interpretation of intrastate contracts should be in accordance with state law. As such, a decision arising from a state court could misinterpret federal law and still rest on an adequate and independent state ground under some circumstances.

As our Statement of the Case fully demonstrates, all decisions below have rested squarely upon the interpretation of federal law. Petitioner recognizes that an attenuated argument could be offered to suggest that the opinion denying the motion for rehearing shifted the basis from federal to state law. Although the short opinion is not free from ambiguity, it maintained the federal justification for refusing to escalate the price under the contract. First, the opinion states it adheres "to the original opinion except as herein clarified." If there had been a shift from federal to state law, the original opinion would conflict with the "clarifying opinion" in a number of respects and it would be disingenuous to suggest that such a sentence would be placed in an opinion wholly changing its ground for decision. Second, the Court's statement that escalation provisions were not nullified by the NGPA, but they "are limited by the terms and conditions agreed to by the parties in the contracts" is nothing more than a reference to the conclusion in its original opinion that, regardless of the intent of the parties, Section 105(b)(1) precluded escalation because of the operation of the timing clause in Article I(b). Third, the *Energy Reserves Group* opinion, handed down the same day as the denial of the Motion for Rehearing, reiterates the Court's Section 105(b)(1) conclusion in full and states the "rationale expressed in the *Mesa Petroleum Company* case is fully applicable

Whether the governing law is state or federal, contracting parties need to be able to rely on uniformity of interpretation. And when the governing law is federal, a healthy federalism requires that States correctly implement federal choices in those spheres where federal authority is supreme. The decision below interprets the governing federal law in a way that conflicts with the

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here." If the opinion denying rehearing had removed the Court's adherence to the original opinion it would hardly be cited the same day as "fully applicable."

A strained reading of the opinion denying rehearing could suggest that the Court abandoned reliance on federal law and adopted the view that as a matter of state law, only a contract calling for the highest price allowed by law would authorize price increases. Such a reading would necessitate the view (1) that the opinion denying rehearing was less than candid in suggesting that parts of the original opinion could still stand and (2) that the citation to the original opinion in *Energy Reserves Group* was inadvertent. Because that reading asks so much and gives the Kansas Supreme Court so little credit for consistency and forthrightness, especially in the face of alternative readings, it ought to be rejected out of hand. But assuming *arguendo* that the Court chose to switch the basis of its decision from federal to state grounds when confronted with a plain error in the application of federal law in the initial opinion, the switch does not constitute an adequate and independent ground under the circumstances here presented. From the two trial courts through the Kansas Supreme Court in three separate opinions there had been unanimous judicial agreement that the NGPA could not and did not result in higher gas prices for intrastate producers under price escalator clauses in the contracts (although the reasons for the conclusion have varied considerably). Against the background of constant judicial hostility to the federal claim and the failure to discuss the thrust of Petitioner's Section 105(b)(1) argument on the Motion for Rehearing, the sudden shift from federal law (which the Kansas courts had always believed prohibited price escalation) to state law (which up to this time had never been seen as a bar) would have no purpose except as a subterfuge to evade the applicable and proper interpretation of federal law. As such it cannot support the judgment below. *Demarest v. City Bank*, 321 U.S. 36 (1944); *Ward v. Love County*, 253 U.S. 17 (1920).

interpretation of both the federal agency charged with implementing the NGPA and the federal court of appeals whose circuit encompasses two of our largest natural gas producing States. Its effect is to negate Congressional intent and to Balkanize federal policy relating to natural gas. It merits plenary review by this Court.

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Appendix

81-711

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No. 81-

IN THE
Supreme Court of the United States
OCTOBER TERM, 1981

MESA PETROLEUM CO.,
Petitioner,
v.
THE KANSAS POWER AND LIGHT COMPANY, INC.,
Respondent.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE KANSAS SUPREME COURT

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APPENDIX A

IN THE DISTRICT COURT
OF GRANT COUNTY, KANSAS

Case No. 79-C-17

MESA PETROLEUM COMPANY,
Plaintiff,

vs.

THE KANSAS POWER AND LIGHT COMPANY,
Defendant.

FINDINGS AND CONCLUSIONS

This case involves a Supplemental Gas Purchase Contract dated February 25, 1976, executed by the parties to this action after prior litigation in this Court. This agreement applies to 22% of the total gas sales by Mesa to KP&L and provided for a price of $1.92 per MCF after April 1, 1978, and $1.94 April 1, 1979. In addition, article I(b) of the agreement provides as follows:

If the Federal Power Commission or any successor governmental authority, or any Kansas regulatory or governmental authority, having jurisdiction in the premises shall at any time hereafter prescribe by law, rate proceeding, rulemaking procedure or a comparable procedure any price applicable to any natural gas of any vintage produced from the Hugoton-Anadarko area and sold intrastate in Kansas or in interstate commerce, which is higher than the price or prices then provided in this Article I to be paid for New Gas delivered hereunder, then the price to be paid for New Gas remaining to be sold hereunder shall be increased to equal such regulated price. In that event, the increased price shall become effective as of the date of action of the gov-

ernmental or regulatory authority establishing the regulated price, or its effective date, whichever is later (subject to the provisions of paragraph (e) below), and shall remain in effect until later changed in accordance with the pricing provisions of the Agreement.

In November 1979 the Natural Gas Policy Act was passed and became effective December 1, 1978. This act provides in section 105 "Ceiling Price For Sales Under Existing Intrastate Contracts" in (b)(1) "the maximum lawful price under this section shall be the lower of

(A) the price under the terms of the existing contract, to which such natural gas was subject on the date of enactment of the Act, as such contract was in effect on such date; or

(B) the maximum lawful price, per million Btu's computed for such month under section 102 (relating to new natural gas)."

There is no dispute that the section 102 gas price was $2.078 per million B.T.U. under a formula to increase on a monthly basis. With adjustments for B.T.U. content and a slight differential in pressure base, plaintiff asserts, and it is not disputed, that this meant $2.05 per MCF if applied to the agreement between the parties.

Pursuant to demand by Mesa, KP&L filed application with the Kansas Corporation Commission on December 7, 1978, to approve the increased price of gas, and a supplemental application on February 2, 1979. On February 15, 1979, Mesa notified KP&L of its election to terminate the contract after failure of the corporation commission to act on the application pursuant to Article I(b) of the supplemental contract.

Mesa, on February 16, 1979, filed this action for declaratory judgment requesting this Court to determine that it had lawfully terminated the supplemental contract. KP&L disputes that Mesa was authorized under the facts

and law to terminate the agreement, and this Court finds that a controversy exists.

Although motions for summary judgment have been filed previously, this Court requested the able counsel involved in this case to submit the case for full determination, and they have complied.

ISSUES

1. Does Article I (b) of the supplemental contract escalate the price to be paid under the Natural Gas Policy Act?

Mesa contends this article is clear on its face and provides for the highest payment allowed by law.

KP&L contends that it is ambiguous and the parties did not anticipate congressional action in setting prices, and that such action is not embraced within the terms of this agreement.

I find the article to be clear and unambiguous, reflecting the intent of the parties to establish as a price the maximum price allowed by federal or state government. Congress is governmental authority and can be a successor to the FPC which it created and has now been succeeded by the Federal Energy Regulatory Commission which administers the National [sic] Gas Policy Act. That neither of the parties anticipated a shift in governmental policy from a cost base regulated price to a market value price does not create ambiguity but reflects the limited clairvoyance of the negotiators of the agreement.

Reference to the Natural Gas Policy Act cited above compels the Court to conclude that the correct application of maximum price is "the price under the terms of the existing contract", and not the section 102 provision as contended by Mesa herein.

Although 102 gas is higher in price, Mesa cannot select the price set forth for new gas, but is bound by the maximum price provision of the act. Thus the reference to "gas of any vintage" in the supplemental contract does not permit the choice sought by Mesa herein. Since the parties to this action have adopted the price provisions of the federal legislation, the validity of the act itself is not in question.

These results are determined on the dates action was taken by Mesa to terminate the contract herein, and make unnecessary a decision as to the application of the Kansas Natural Gas Price Protection Act K.S.A. 1979 Supp. 55-1401 et. Seq. enacted after this suit was filed.

Also this leaves out the question of the five gas wells drilled after February 19, 1977, and involved in this supplemental agreement. The Kansas Price Protection Act, by definition, defines these as new wells and excludes application of the act as to them. Thus it makes no difference as to the actual use made of the wells or the intent of the parties to this action. This is noted in an attempt to resolve all issues presented. However, Mesa has made no demand for price adjustment as to the production from these wells, nor were they included as cause for termination. Hence, they have no effect on the declaratory judgment sought by Mesa in this action.

I request the defendant to prepare a journal entry in accordance with these findings.

Dated: June 13, 1980

/s/ Keaton G. Duckworth
KEATON G. DUCKWORTH

APPENDIX B

IN THE DISTRICT COURT OF GRANT COUNTY, KANSAS

Case No. 79-C-17

MESA PETROLEUM CO.,
Plaintiff,

vs.

THE KANSAS POWER AND LIGHT COMPANY,
Defendant.

JOURNAL ENTRY

This is a declaratory judgment action submitted to the Court on stipulations, briefs, and oral argument of counsel. Being fully advised in the premises, the Court makes the following findings and conclusions:

FINDINGS

1. This case involves a Supplemental Gas Purchase Contract dated February 25, 1976, executed by the parties to this action after prior litigation in this Court.

2. This agreement applies to 22% of the total gas sales by Mesa to KPL and provided for a price of $1.92 per Mcf after April 1, 1978, and $1.94 after April 1, 1979.

3. In addition, Article I(b) of the agreement provides as follows:

> If the Federal Power Commission or any successor governmental authority, or any Kansas regulatory or governmental authority, having jurisdiction in the premises shall at any time hereafter prescribe by law, rate proceedings, rulemaking procedure or a comparable procedure any price applicable to any

> natural gas of any vintage produced from the Hugoton-Anadarko area and sold interstate [sic] in Kansas or in interstate commerce, which is higher than the price or prices then provided in this Article I to be paid for New Gas delivered hereunder, then the price to be paid for New Gas remaining to be sold hereunder shall be increased to equal such regulated price. In that event, the increased price shall become effective as of the date of action of the governmental or regulatory authority establishing the regulated price, or its effective date, whichever is later (subject to the provisions of paragraph (c) [sic] below), and shall remain in effect until later changed in accordance with the pricing provisions of the Agreement.

4. Mesa, on February 16, 1979, filed this action for declaratory judgment requesting this Court to determine that it had lawfully terminated the supplemental contract. KPL disputes that Mesa was authorized under the facts and law to terminate the agreement, and this Court finds that a controversy exists.

5. In November, 1978, the Natural Gas Policy Act was passed and became effective December 1, 1978.

6. The NGPA provides in Section 105 "Ceiling Price For Sales Under Existing Intrastate Contracts" in (b)(1) "the maximum lawful price under this section shall be the lower of

> (A) the price under the terms of the existing contract, to which such natural gas was subject on the date of enactment of this Act, as such contract was in effect on such date; or
>
> (B) the maximum lawful price, per million Btu's computed for such month under Section 102 (relating to new natural gas)."

7. The Section 102 gas price was $2.078 per million Btu under a formula to increase on a monthly basis.

With adjustments for Btu content and a slight differential in pressure base, the Section 102 gas price would be $2.05 per Mcf if applied to the agreement between the parties.

8. Pursuant to demand by Mesa, KPL filed application with the Kansas Corporation Commission on December 7, 1978, to approve the increased price of gas, and a supplemental application on February 2, 1979.

9. On February 15, 1979, Mesa notified KPL of its election to terminate the contract after failure of the corporation commission to act on the application pursuant to Article I(b) of the supplemental contract.

10. Mesa made no demand for price adjustment as to the production from five wells subject to the supplemental contract and drilled after February 19, 1977, nor did Mesa include these wells as cause for this termination.

CONCLUSIONS

1. Article I(b) of the supplemental contract is clear and unambiguous, reflecting the intent of the parties to establish as a price the maximum price allowed by federal or state government.

2. Congress is a governmental authority and can be a successor to the FPC which it created and has now been succeeded by the Federal Energy Regulatory Commission which administers the Natural Gas Policy Act.

3. By reference to the Natural Gas Policy Act, the correct application of the maximum price is "the price under the terms of the existing contract," and not the Section 102 provision as contended by Mesa herein.

4. Although Section 102 gas is higher in price, Mesa cannot select the price set forth for new gas, but is bound by the maximum price provision of the Act. Thus the reference to "gas of any vintage" in the supplemental contract does not permit the choice sought by Mesa herein.

5. Since the parties to this action have adopted the price provisions of the federal legislation, the validity of the Act itself is not in question.

6. These results are determined on the dates action was taken by Mesa to terminate the contract herein and make unnecessary a decision as to the application of the Kansas Natural Gas Price Protection Act, K.S.A. 1980 Supp. Section 55-1401 et seq., enacted after this suit was filed.

7. The Kansas Price Protection Act, K.S.A. 1980 Supp. 55-1401 et seq., defines the five gas wells drilled after February 19, 1977, and involved in this supplemental agreement, as new wells and excludes application of the Act as to them. Thus it makes no difference as to the actual use made of the wells or the intent of the parties to this action.

8. However, because Mesa made no demand for price adjustment as to the production from these wells, nor included them as cause for termination, these wells have no effect on the declaratory judgment sought by Mesa in this action.

9. Plaintiff's prayer for a declaratory judgment is hereby denied and judgment is accordingly entered for defendant The Kansas Power and Light Company. Costs shall be taxed to the plaintiff.

KEATON G. DUCKWORTH
District Judge

Approved as to form and content:

/s/ Richard C. Byrd
Counsel for Plaintiff
/s/ Basil W. Kelsey
Counsel for Defendant

APPENDIX C

IN THE
SIXTEENTH JUDICIAL DISTRICT OF KANSAS
CLARK AND MEADE COUNTIES, KANSAS

Case No. 79-C-38
Meade County

Case No. 79-C-22
Clark County

MESA PETROLEUM CO.,
Plaintiff,

vs.

KANSAS POWER AND LIGHT COMPANY
AND THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS,
Defendants.

CONCLUSIONS OF LAW

Plaintiff, Mesa Petroleum Company (Mesa), filed both actions asking the Court for declaratory judgment, that on February 15, 1979, it terminated its gas supply contract with the defendant Kansas Power and Light Company (KP&L) based on the latter's failure to pay an increased price for such gas claimed by Mesa under the contract as of December 1, 1978. On the other hand, defendant KP&L has counterclaimed for declaratory judgment, that the price of gas purchased thereunder did not escalate on December 1st, and that the contracts remained in full force and effect.

The State Corporation Commission of Kansas has intervened as a defendant to defend the constitutionality of The Kansas Price Protection Act.

The parties to this action have done a masterful job of supplying the Court with briefs. The case was orally argued in Dodge City, Kansas, by agreement of the parties and the Court. Now, after considering briefs and oral argument of counsel, the Court is prepared to make conclusions of law.

The Court incorporates as its findings of fact all of the stipulations of the parties contained in the Pretrial Order as well as the parties' supplements to the Pretrial Order.

CONCLUSIONS OF LAW

1. Paragraph 6.2 of the contracts executed by the parties herein is entitled, "The Governmental Price Regulation" clause. It provides for the price of gas delivered under this contract to escalate when a "successor governmental authority" to the Federal Power Commission (FPC) "prescribes" a price for gas under the contract, which exceeds the contract price, then in effect.

2. Congress is not a "successor governmental authority" to the FPC, and the enactment of the Natural Gas Policy Act of 1978 (NGPA), 15 USC 3301, et seq. 1979, was not the action of a "successor governmental authority" within the parties' intentions and contemplations on the date the contracts were executed.

3. The NGPA, by its very terms and conditions, did not prescribe or regulate, but did set interim ceiling prices. It was a national policy decision by Congress to deregulate, not to actually *prescribe prices* within any definition of that term.

4. Since Congress is not a "successor governmental authority" and the NGPA did not prescribe prices, it follows that the creation of the NGPA did not trigger the escalation clause pursuant to Paragraph 6.2 of the subject contracts.

5. The Federal Energy Regulatory Commission (FERC) was charged with the duty of administration of the NGPA. The FERC issued its interim regulations, effective December 1, 1978, that prohibited price escalation, which would have been based on the NGPA establishment of higher prices.

6. By statement of policy on January 24, 1979, the FERC determined that Congress was not a "*successor governmental authority*" to the former regulatory agency, the FPC.

7. The NGPA specifically cedes to the states the authority to legislate to protect against price escalation. The State of Kansas, by passage of the Kansas Natural Gas Price Protection Act, 55-1401 expressly, specifically and definitely forbids activation of indefinite price escalator clauses on or after December 1, 1978.

8. The Kansas Price Protection Act is reasonable legislation enacted to cushion the price of natural gas sold to its citizens, and does not impair the "*governmental regulation*" clause in these contracts. It is, in my judgment, a legitimate and judicious exercise of the police power of the state and does not violate the contract clause of the United States Constitution, Article 1, § 10, nor does the retroactive application to these contracts violate the constitution.

9. Under the Kansas Natural Gas Price Protection Act, indefinite price escalator clauses were given effect after March 1, 1979, on gas produced from new wells. It is agreed that defendant did not pay the increased price. I find, however, that such failure did not constitute a breach of the contracts, and, consequently, such failure was not a basis for termination of these contracts by plaintiff.

10. Mesa's remaining federal and state constitution challenges lack merit.

DECISION

Based on the above and foregoing conclusions of law and the stipulated facts contained in the Pretrial Order and supplements thereto, the Court finds that the indefinite price escalator clauses contained in Paragraph 6.2 were not activated on December 1, 1978, and, therefore, Mesa was not entitled to terminate the subject contracts.

Judgment is hereby entered in favor of the defendants on their counterclaims and against the plaintiff on its petition and the costs should be taxed to the plaintiff.

/s/ Don C. Smith
DON C. SMITH
District Judge

APPENDIX D

IN THE
SIXTEENTH JUDICIAL DISTRICT OF KANSAS
CLARK AND MEADE COUNTIES, KANSAS

Case No. 79-C-38
Meade County

Case No. 79-C-22
Clark County

MESA PETROLEUM CO.,
Plaintiff,

vs.

KANSAS POWER AND LIGHT COMPANY
AND THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS,
Defendants.

JOURNAL ENTRY

Plaintiff, Mesa Petroleum Company (Mesa), filed both actions asking the Court for declaratory judgment, that on February 15, 1979, it terminated its gas supply contract with the defendant The Kansas Power and Light Company (KPL) based on the latter's failure to pay an increased price for such gas claimed by Mesa under the contract as of December 1, 1978. On the other hand, defendant KPL has counterclaimed for declaratory judgment, that the price of gas purchased thereunder did not escalate on December 1st, and that the contracts remained in full force and effect.

The State Corporation Commission of Kansas has intervened as a defendant to defend the constitutionality of the Kansas Price Protection Act.

The case was orally argued in Dodge City, Kansas by agreement of the parties and the Court. After consider-

ing briefs and oral argument of counsel, and being fully advised in the premises, the Court makes the following findings and conclusions:

FINDINGS

The Court incorporates as its findings of fact all of the stipulations of the parties contained in the Pre-Trial Order as well as KPL's and Mesa's respective Supplements to the Pre-Trial Order. They are as follows:

1. On March 19, 1976, Mesa and KPL entered into two contracts for the intrastate sale of natural gas from dedicated acreage in Meade and Clark Counties, Kansas. The two contracts are referred to as the "Adams Ranch" and "Ashland Prospect" contracts, copies of which are marked Exhibits 1 and 2, attached to the Pre-Trial Order and made a part thereof.

2. The original price for natural gas as defined in the contracts referenced in paragraph 1 above was $1.50 per mcf on March 19, 1976. On March 27, 1977, the price escalated to $1.52 as a result of a $0.2 annual fixed price escalation. The price was redetermined pursuant to the contracts on March 27, 1978, to $1.88 per mcf. The contract provides for a fixed price escalation of $.02 each year. The actual price paid for gas under both contracts by KPL to Mesa on November 9, 1978, was $1.88 per mcf.

3. The NGPA was enacted on November 9, 1978, and the price provisions thereof were effective December 1, 1978. A copy of the NGPA is marked Exhibit 3, attached to the Pre-Trial Order and made a part thereof.

4. The gas under the contract is intrastate gas sold under an existing intrastate contract and is subject to the provisions of Section 105(b)(1) of the NGPA.

5. Under Section 271.101 of the FERC's Rules and Regulations, the price for Section 102 natural gas is

set forth and for the month of December, 1978, was $2.078 per million BTU's measured at a pressure of 14.73 psia. For July, 1980, the price for Section 102 natural gas is $2.504 per million BTU's measured at a pressure of 14.73 psia. (A copy of Section 271.101 of the FERC's Rules and Regulations marked Exhibit 4 is attached to the Pre-Trial Order and made a part thereof.)

6. KPL received a letter from Mesa dated November 30, 1978, a copy of which is marked Exhibit 5, attached to the Pre-Trial Order and made a part thereof.

7. The Kansas Corporation Commission (KCC) started accepting applications for the determination of certain natural gas categories under the NGPA on December 1, 1978.

8. Effective December 1, 1978, FERC promulgated Interim Regulations Implementing the NGPA and such Interim Regulations contained the following:

> § 270.205. "Indefinite Price Escalator Clauses The establishment of maximum lawful prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate or interstate contracts."

The Regulations Preamble to which said regulation was attached stated:

> Section 270.205 incorporates discussion at page 83 of the Statement of Managers which relates to the effect of establishment of ceiling prices under the NGPA on indefinite price escalator clauses in existing contracts. As discussed there, the mere establishment of NGPA ceiling prices will not trigger these clauses. The special rule is consistent with that discussion which is equally applicable to existing intrastate and interstate contracts. (CCH Vol. II ¶ 30,206 p. 30,147)

> One comment suggested adding a new section which would provide, *inter alia*, that the mere establishment of ceiling prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate contracts. Only prices actually paid for sales actually made under the NGPA would trigger such clauses. This is similar to language at page 83 of the Joint Explanatory Statement of the Committee on Conference and reflects, in our opinion, the general intent of Congress with respect to sales under all existing contracts, whether inter- or intrastate. Accordingly as discussed above, we have added a new section 270.205 which provides that the establishment of maximum lawful prices under the NGPA shall not trigger "indefinite price escalator provisions," as defined in the NGPA in either existing intrastate or interstate contracts. (CCH Vol. II ¶ 30.026 p. 30,162 and 30,163)

The Statement of Managers at page 83 stated:

> The conferees do not intend that the mere establishment of the ceiling prices under this Act shall trigger indefinite price escalator clauses in existing intrastate contracts. Once natural gas is sold pursuant to the ceiling prices under this Act, such clauses would be activated as limited by this section.

9. On March 13, 1979, FERC issued its Final Regulations amending and modifying Section 270.205, a copy of which is marked Exhibit 15 attached to the Pre-Trial Order and made a part thereof.

10. KPL filed an application with the KCC on December 7, 1978, and a supplemental application was filed on February 2, 1979, copies of which are marked Exhibits 6 and 7, attached to the Pre-Trial Order and made a part thereto.

11. The KCC took no action with respect to such application within sixty (60) days of the filing of such application and KPL did not pay the increased price demanded by Mesa.

12. On December 5, 1978, KPL sent a letter to Mesa, marked Exhibit 8, attached to the Pre-Trial Order and made a part thereof.

13. On February 15, 1979, Mesa sent a letter to KPL, marked Exhibit 9, attached to the Pre-Trial Order and made a part thereof.

14. The Kansas Natural Gas Price Protection Act ("Price Protection Act") was enacted on May 29, 1979, and was according to its terms, effective December 1, 1978. A copy of the Price Protection Act is marked Exhibit 10, attached to the Pre-Trial Order and made a part thereof.

15. The Price Protection Act constitutes the first time that the Kansas Legislature has placed the production of natural gas under wellhead price regulation.

16. The majority and minority committee reports accompanying the Kansas Natural Gas Price Protection Act were filed on May 14, 1979. (Copies are marked as Exhibit 11, attached to the Pre-Trial Order and made a part thereof.)

17. On November 9, 1979, the KCC dismissed the application and supplemental application referred to in Stipulation No. 8 above. (A copy of the order is marked Exhibit 12, attached to the Pre-Trial Order and made a part thereof.)

18. On December 1, 1978, Imperial Oil Company made applications to the State Corporation Commission for natural gas well classification determinations for the following natural gas wells: Huck No. 1-17, API Well Identification No. 15-097-20429, Docket No. NGPA-K-78-

0025; Curtis No. 1-Levin, API Well Identification No. 15-047-20278, Docket No. NGPA-K-0026; Crooked L Ranch No. 1-21, API Well Identification No. 15-119-20259, Docket No. NGPA-K-78-0006.

19. The above-named wells produced natural gas during the month of December, 1978 and through the calendar year 1979, that was delivered to and purchased by Northern Natural Gas Company (Huck No. 1-17), Kansas-Nebraska Natural Gas Co., Inc. (Curtis No. 1-Levin), Michigan-Wisconsin Natural Gas Company (Crooked L. Ranch No. 1-21), respectively.

20. The foregoing purchasers made a payment for December, 1978 production on or about January 25, 1979 in the following amounts: $1.5209 per MCF (Northern Natural Gas Company—Huck No. 1-17), $1.63 per MMBTU (Kansas-Nebraska Natural Gas Co., Inc., Curtis No. 1-Levin), $1.63 per MMBTU (Michigan-Wisconsin Pipe Line Company, Crooked L. Ranch No. 1-21). Payments of the difference between the earlier payments and the higher NGPA Section 102 price for gas deliveries made in December, 1978, January, February, March and April, 1979, were made on or about May 25, 1979 by Kansas-Nebraska Natural Gas Co., subject to refund, on or about June 25, 1979 by Michigan Wisconsin Pipe Line Company, subject to refund, and on or about November 5, 1979 by Northern Natural Gas Company.

21. On March 13, 14 and 15, 1979, Imperial Oil Company made filings with FERC under Section 273.202 of FERC's Regulations for authority to collect sales proceeds pending jurisdictional agency determinations of the above-named wells.

22. Northern Natural Gas Company first paid to Imperial Oil Company NGPA Section 102 prices, subject to refund, on or about August 25, 1979, for gas delivered in May, June and July, 1979. Kansas-Nebraska Natural Gas Co., Inc., first paid to Imperial Oil Company NGPA

Section 102 prices, subject to refund, on or about May 25, 1979, for gas delivered in April. Michigan-Wisconsin first paid Imperial Oil Company Section 102 prices, subject to refund, on Crooked L. Ranch No. 1-21 on or about June 25, 1979 for gas delivered in May, 1979.

23. Under Section 291.101 [sic] of FERC's Rules and Regulations, the price for Section 108 is set forth and for the month of December, 1978, was $2.224 per million BTU's.

24. Under Section 271.101 of FERC's Rules and Regulations, the highest price for Section 104 is set forth and for the month of December, 1978 was $1.630 per million BTU's.

25. Under Section 271.101 of FERC's Rules and Regulations, the price for Section 109 is set forth and for the month of December, 1978, was $1.630 per million BTU's.

26. On January 24, 1979, FERC issued its "Policy Respecting Area Rate Clauses and Indefinite Price Escalator Clauses," a copy of which is marked Exhibit 17, attached to Supplement of Defendant KPL to Pre-Trial Order and made a part thereof.

27. Mesa's operating income for the year 1979 was $97,182,000 on revenues of $269,420,000 and its operating income for the year 1978 was $68,036,000 on revenues of $166,517,000.

28. James O. Upchurch, Vice President-Engineering of Mesa, appeared before the Kansas Joint Committee on Energy and Natural Resources to urge the 1979 Kansas legislature not to pass the Kansas Natural Gas Price Protection Act.

29. Imperial Oil Company made deliveries of gas from wells in Kansas in December 1978, and thereafter in reliance on Section 503(e)(2) of the NGPA and Sections 273.202 of FERC's Rules and Regulations. Copies

of Section 503(e)(2) of the NGPA and Section 273.202(a) of FERC's Rules are marked as Exhibit 13, attached to Supplement of Plaintiff Mesa to Pre-Trial Order and made a part thereof.

30. The Affidavit of Robert C. Spurlock of Imperial Oil Company, copies of interim collection filings, copies of applications for Section 102 classification determinations and corresponding documents are marked as Exhibit 14, attached to Supplement of Plaintiff Mesa to Pre-Trial Order and made a part thereof.

31. The retroactive collection procedures, after a final agency determination, are set forth in Section 273.204 of the FERC's Rules and Regulations. A copy of Section 273.204 of the FERC's Rules and Regulations are marked as Exhibit 16, attached to Supplement of Plaintiff Mesa to Pre-Trial Order and made a part thereof.

32. The surface drilling of wells under the Adams Ranch contract began on the following dates:

Well Name	Drilling Date	Connection Date
Adams 1-2	1-04-75	11-05-76
Adams 2-2	2-26-75	6-28-77
Adams 1-33 Chester	3-03-75	11-04-76
Morrow	3-03-75	11-04-76
Adams 1-36	5-19-75	11-05-76
Barragree 1-8 Morrow	6-26-75	11-05-76
Chester	6-26-75	11-05-76
Adams 1-34	7-17-75	11-05-76
Adams 2-35 Chester	1-27-76	11-05-76
Toronto	1-27-76	11-05-76
Barragree 1-25 Chester	11-23-76	2-10-77
Morrow	11-23-76	2-10-77
Toronto	11-23-76	2-10-77
Adams 2-33	12-08-76	2-02-77
Adams 1-18 Chester	12-30-76	8-10-77
Morrow	12-30-76	8-10-77
St. Louis	12-30-76	8-10-77
Merkle 1-7 St. Louis	2-14-77	9-15-77
Adams 2-34 Chester	3-06-77	8-22-77
Morrow	3-06-77	8-22-77
Adams 3-35 Chester	7-05-77	2-01-78
Morrow	7-05-77	2-01-78
Toronto	7-05-77	2-01-78

Well Name	Drilling Date	Connection Date
Adams 1-27 Chester	7-23-77	2-02-78
Morrow	7-23-77	2-02-78
Barragree 2-17 Chester	8-12-77	12-12-77
Morrow	8-12-77	12-12-77
St. Louis	8-12-77	10-27-77
Adams 4-2	8-13-77	12-29-78
Pinnick 1-24	9-15-77	4-21-78
Rosson 1-32	2-23-78*	
Adams 3-33	8-18-78	10-12-78
Merkle 2-7	9-07-78	10-27-78
Adams 2-18 Chester	12-13-78	3-01-79
Morrow	12-13-78	3-01-79
Adams 3-18 Chester	4-19-79	7-31-79
St. Louis	4-19-79	7-31-79
Barragree 2-25	10-25-79	5-29-80
Adams 4-18	1-31-80	Not connected

* Re-entry of old well spudded before 2-19-77. (not a new well)

33. The surface drilling of wells under the Ashland Prospect contract began on the following dates:

Well Name	Drilling Date	Connection Date
Daily 1-1	1-02-76	9-15-76
Daily 1-6	1-21-76	10-05-76
Daily 2-6	2-08-76	10-05-76
Daily 3-6 (Salt Water Disposal Well)	2-23-76	
Seacat 1-19	2-04-77	10-19-77
Seacat 2-19	9-15-78	12-19-78
Moore 2-20	11-15-78	5-31-79
Moore 1-20	11-16-78	12-14-78
Seacat 3-19	12-30-78	2-23-79
Moore 3-20	3-21-79	7-05-79
Francis 1-20*	4-12-79	
Moore 2-29	4-23-79	5-14-79
Francis 2-20*	5-01-79	
McPhail 1-29	5-19-79	8-16-79
Moore 3-29	5-25-79	Dry Hole
Moore 4-29	7-29-79	12-07-79
Moore 5-29	11-18-79	Dry Hole
Daily 1-7	2-28-80	Not connected
Giles 1-13	3-14-80	Not connected
Jenkins 1-1	4-04-80	Not connected

* Released from Contract by KPL due to high hydrogen sulphide content.

34. 24.191% of KPL's sales were made internally for use by KPL. Industrial sales constitute 37.518% of KPL's natural gas sales. Residential sales amount to about 19.438% of KPL's natural gas sales.

35. 39.898% of KPL's natural gas supply is purchased under contracts entered into before April 20, 1977, with indefinite escalator clauses.

36. KPL's operating income for the year 1979 was $45,900,000 on revenues of $330,437,000. KPL's operating income for the year 1978 was $35,801,000 on revenues of $317,740,000.

37. During the 1979 Legislative Session, John G. Williamson, who negotiated the Supplemental Contract for KPL, and David S. Black, who is General Counsel of KPL, appeared before the Kansas Joint Committee on Energy and Natural Resources on behalf of KPL and testified in favor of the passage of legislation placing restrictions on escalator provisions in gas purchase contracts. Additionally, KPL made public statements in support of H.B. 2680.

38. KPL purchases gas for distribution in certain cities in Kansas from Cities Service Gas Company and Northern Natural Gas Company. To the extent that these companies have increased their gas costs as a result of NGPA prices and area rate clauses in their producer contracts, KPL is including said increases in the price of the gas it sells in those cities.

CONCLUSIONS OF LAW

1. Paragraph 6.2 of the contracts executed by the parties herein is entitled, "The Governmental Price Regulation" clause. It provides for the price of gas delivered under this contract to escalate when a "successor governmental authority" to the Federal Power Commission (FPC) "prescribes" a price for gas under the contract, which exceeds the contract price, then in effect.

2. Congress is not a "successor governmental authority" to the FPC, and the enactment of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301, et seq. 1979, was not the action of a "successor governmental authority" within the parties' intentions and contemplations on the date the contracts were executed.

3. The NGPA, by its very terms and conditions, did not prescribe or regulate, but did set interim ceiling prices. It was a national policy decision by Congress to deregulate, not to actually *prescribe prices* within any definition of that term.

4. Since Congress is not a "successor governmental authority" and the NGPA did not prescribe prices, it follows that the creation of the NGPA did not trigger the escalation clause pursuant to Paragraph 6.2 of the subject contracts.

5. The Federal Energy Regulatory Commission (FERC) was charged with the duty of administration of the NGPA. The FERC issued its interim regulations, effective December 1, 1978, that prohibited price escalation, which would have been based on the NGPA establishment of higher prices.

6. By statement of policy on January 24, 1979, the FERC determined that Congress was not a "*successor governmental authority*" to the former regulatory agency, the FPC.

7. The NGPA specifically cedes to the states the authority to legislate to protect against price escalation. The State of Kansas, by passage of the Kansas Natural Gas Price Protection Act, 55-1401 expressly, specifically and definitely forbids activation of indefinite price escalator clauses on or after December 1, 1978.

8. The Kansas Price Protection Act is reasonable legislation enacted to cushion the price of natural gas sold to its citizens, and does not impair the "*governmental regulation*" clause in these contracts. It is, in my judg-

ment, a legitimate and judicious exercise of the police power of the state and does not violate the contract clause of the United States Constitution, Article 1, § 10, nor does the retroactive application to these contracts violate the constitution.

9. Under the Kansas Natural Gas Price Protection Act, indefinite price escalator clauses were given effect after March 1, 1979, on gas produced from new wells. It is agreed that defendant did not pay the increased price. I find, however, that such failure did not constitute a breach of the contracts, and, consequently, such failure was not a basis for termination of these contracts by plaintiff.

10. Mesa's remaining federal and state constitution challenges lack merit.

11. Based on the above and foregoing conclusions of law and the stipulated facts, the Court finds that the indefinite price escalator clauses contained in Paragraph 6.2 were not activated on December 1, 1978, and, therefore, Mesa was not entitled to terminate the subject contracts.

12. Judgment is hereby entered in favor of the defendants on their counterclaims and against the plaintiff on its petition and the costs should be taxed to the plaintiff.

DON C. SMITH
District Judge

APPROVED AS TO
FORM AND CONTENT:

/s/ Walker Hendrix
WALKER HENDRIX

Counsel for Plaintiff

/s/ Terence L. Mundorf
TERENCE L. MUNDORF

Counsel for Defendant
State Corporation
Commission

/s/ Basil W. Kelsey
BASIL W. KELSEY
Counsel for Defendant KPL

APPENDIX E

No. 52,646

MESA PETROLEUM COMPANY,
Appellant,

v.

THE KANSAS POWER AND LIGHT COMPANY,
Appellee.

SYLLABUS BY THE COURT

In an appeal from a judgment in which it is determined the indefinite price escalator clause contained in a gas purchase contract was not triggered by the establishment of maximum prices in the Natural Gas Policy Act of 1978 (15 U.S.C. § 3301, *et seq.* [1979]), the record is examined and it is *held*, the contract price was not escalated, the attempted termination of the contract was ineffective, and the district court's judgment is affirmed.

Appeal from Grant district court, KEATON G. DUCKWORTH, judge. Opinion filed June 10, 1981. Affirmed.

Richard C. Byrd, of Anderson, Byrd & Richeson, of Ottawa, argued the cause, and *Walker A. Hendrix*, of the same firm, *E. F. Russell*, of Ulysses, and *Barry Cannaday*, of Amarillo, Texas, were with him on the briefs for the appellant.

Jerome T. Wolf, of Spencer, Fane, Britt & Browne, of Kansas City, Missouri, argued the cause, and *Basil W. Kelsey* and *Terry W. Schackmann*, of the same firm, *Gene H. Sharp*, of Vance, Hobble, Neubauer, Nordling, Sharp & McQueen, P.A., of Liberal, *David S. Black*, of Topeka, and *James L. Grimes, Jr.*, of Cosgrove, Webb & Oman, of Topeka, were with him on the briefs for the appellee.

The opinion of the court was delivered by

FROMME, J.: Mesa Petroleum Company (Mesa) filed this action for a declaratory judgment asking the trial court to determine that it legally terminated a gas supply contract with the defendant, The Kansas Power and Light Company (KP&L). The question of whether the contract was legally terminated depends on an interpretation of Section 105(b)(1) of the Natural Gas Policy Act of 1978 (N.G.P.Act), 15 U.S.C. § 3315(b)(1) (1979), and an interpretation of the terms of the gas supply contract of the parties which contract contained an indefinite price escalator clause.

A large number of the existing contracts providing for the sale of gas contain what are referred to as price escalator clauses of one kind or another which permit upward price adjustments during the term of the contract. These upward price adjustments do not provide for fixed or definite price increments and frequently are not tied to a specific schedule but are "triggered" by other occurrences, such as an increase in government regulated prices.

Some background of the N.G.P.Act will be helpful in understanding the questions here involved. The N.G.P. Act was adopted November 9, 1978, and became effective December 1, 1978. It mandated a new legislative framework for deregulation of the natural gas industry. It established a comprehensive scheme of statutorily prescribed maximum ceiling prices applicable to separate, distinct types of "first sales" of natural gas occurring in both interstate and intrastate commerce. In many respects this new law limited, replaced or superseded the controls and regulations existing under the previous controlling federal statute, The Natural Gas Act, 15 U.S.C. § 717, *et seq.* (1976). The N.G.P.Act terminated the authority of the Federal Energy Regulatory Commission (FERC) to prescribe area rates for natural gas under

the Natural Gas Act, as FERC and its predecessor agencies had done for years. See 15 U.S.C. § 3431 (1979).

In contrast to the Natural Gas Act, the N.G.P.Act has for its purpose the deregulation of natural gas prices and the establishment of a maximum pricing system designed to phase in higher gas prices gradually over a six year period, ultimately achieving substantial deregulation of gas prices in the year 1985. See 15 U.S.C. § 3331 (1979); *State of Okl., Etc. v. Federal Energy Reg. Com'n*, 494 F. Supp. 636 (W.D.Okla. 1980). Both the terms of the new statute and its legislative history demonstrate that the prices prescribed in Title I of the N.G.P.Act are ceiling prices. Contractual provisions governing the purchase and sale of natural gas are not superseded or nullified unless they should provide for price escalation in excess of the statutory ceilings. FERC Order No. 23, 44 Fed. Reg. 16895 (1979). The maximum lawful price under the N.G.P.Act was set as the lower of the price under the terms of any existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date, or the maximum lawful price for the appropriate vintage of gas as set by the N.G.P.Act. The maximum lawful prices for new natural gas are set as provided in 15 U.S.C. § 3312 (1979), and are generally referred to as Section 102 prices. The maximum lawful prices for old natural gas are set as provided in 15 U.S.C. § 3319 (1979) and are generally referred to as Section 109 prices. Sections 102 and 109 refer to sections of the N.G.P.Act. Sections 3312 and 3319 refer to sections under title 15 U.S.C.

We now turn to the facts of the present case which were stipulated to by the parties.

On May 28, 1970, Mesa and KP&L entered into a contract for the intrastate sale of natural gas from the Chase Group Formation and the Council Grove Forma-

tion in the Hugoton Gas Field in Kansas. In 1976, Mesa made plans to build and operate a new cryogenic nitrogen rejection plant to extract ethane and other liquids that were reserved under the contract. The question of Mesa's right to extract additional liquids from the natural gas stream was the subject of a lawsuit between Mesa and KP&L in the District Court of Grant County. The district court held that Mesa had reserved the right to extract ethane under the contract. The extraction would have resulted in a stipulated twenty-two percent (22%) reduction in natural gas to be received by KP&L.

In exchange for Mesa not building the cryogenic plant and thus saving the twenty-two percent of the natural gas under the contract, KP&L entered into the supplemental contract with Mesa which is now under consideration. The supplemental contract was dated February 25, 1976. It provided that the natural gas would be sold at prices which escalated over the life of the contract.

The original price for the twenty-two percent of natural gas was $1.52 per mcf on February 25, 1976. The price escalated to $1.54 on April 1, 1977, as a result of a two cent annual fixed price escalation under Article I(a). The price was redetermined to $1.92 on April 1, 1978, pursuant to Article I(d) of the contract, which provides a procedure for redetermining the price based on prices in Kansas, Oklahoma, New Mexico and the Texas Panhandle and other factors.

The price of the remaining seventy-eight percent of natural gas continued to be governed by the 1970 contract. The current price for the seventy-eight percent of natural gas is 24.46 cents per mcf. This price is limited to a fixed two cent escalation every five years. We are not concerned with the 1970 contract.

Article I(b) of the supplement contract provided for escalation of the price of the twenty-two percent of nat-

ural gas in the event a governmental authority prescribed a higher price. Article I(b) stated:

> "(b) *Governmental Price Regulations: If* the Federal Power Commission or *any successor governmental authority*, or any Kansas regulatory or governmental authority, having jurisdiction in the premises *shall* at any time hereafter *prescribe by law*, rate proceeding, rulemaking procedure or a comparable procedure *any price applicable to any natural gas* of any vintage produced from the Hugoton-Anadarko area and *sold intrastate* in Kansas or in interstate commerce, *which is higher than the price* or prices then *provided in Article I* to be paid for New Gas delivered hereunder, *then the price to be paid for New Gas remaining to be sold hereunder shall be increased to equal such regulated price.* In that event, *the increased price shall become effective* as of *the date of action of the governmental* or regulatory *authority* establishing the regulated price, *or its effective date, whichever is later* (subject to the provisions of paragraph (e) below), and shall remain in effect until later changed in accordance with the pricing provisions of this Agreement." Emphasis supplied.

On November 9, 1978, the N.G.P.Act was enacted. It prescribed certain maximum or ceiling prices for separate, distinct categories of natural gas. Section 105 of the Act established the maximum price to be paid under an intrastate contract for new gas. Section 105 of the Act provides:

> "(a) Application—*The maximum lawful price* computed under subsection (b) of this section *shall apply* to any first sale of natural gas delivered during any month in the case of natural gas, sold under any existing contract or any successor to an existing

contract, which was not committed or dedicated to interstate commerce *on November 8, 1978.*

"(b) Maximum Lawful Price—

"(1) General Rules—Subject to paragraphs (2) and (3), the *maximum lawful price* under this section *shall be the lower of*—

"(A) *the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978,* as such contract was in effect on such date; *or*

"(B) *the maximum lawful price,* per million Btu's, computed for such month *under Section 3312* of this title (relating to new natural gas).

. . . .

"(c) Definition of contract price—For purposes of this section, the term 'contract price', when used with respect to any specific date, means—

"(1) the price paid, per million Btu's under a contract for deliveries of natural gas occurring on such date; or

"(2) if no deliveries of natural gas occurred under such contract on such date, the price, per million Btu's, that would have been paid had such deliveries occurred on such date." Emphasis supplied.

The Section 102 price for the month of December, 1978, was $2.078 per million BTU's as compared to the preexisting price of $1.92 being paid under the supplemental contract.

On November 22, 1978, Mesa informed KP&L by letter that the price under the supplemental contract would escalate as a result of the N.G.P.Act to $2.078 per million BTU's for the month of December, 1978. The N.G.P.Act

maximum ceiling prices became effective on December 1, 1978.

In accordance with Article I(e) of the supplemental contract, KP&L filed an application with the Kansas Corporation Commission (KCC) on December 7, 1978, for the purpose of seeking permission to include the increased price requested by Mesa in its cost of purchased gas. Article I(e) (of the supplemental contract) provided:

> "(e) *KCC Action*: KPL shall have no obligation to pay any increase in prices pursuant to provisions for escalation (paragraph (a) above), governmental price regulation (paragraph (b) above), deregulation (paragraph (c) above), price redetermination (paragraph (d) above), or infill drilling (Article III, paragraph (d) below), until the effective date of the pass-on thereof as authorized by the Kansas Corporation Commission ("KCC"), except as hereinafter provided.
>
> "KPL shall make application to the KCC for approval of the pass-on of any such increased costs of gas not later than 60 days prior to the date the applicable increase is scheduled to become effective, or within five days after the increase has been established by arbitration or by action of governmental or regulatory authorities. The failure of the KCC to approve a pass-on within 60 days after application by KPL shall be deemed a rejection of the price increase for the purposes of this Agreement.
>
> "KPL shall have the option, to be exercised by written notice to Mesa not later than 15 days after the KCC shall have rejected any such pass-on, to pay the increased price and in such event the provisions of this Agreement shall remain in effect. If

> KPL does not elect to pay such increase then Mesa shall have the option (to be exercised by written notice delivered to KPL not later than 30 days after the KCC shall have rejected any such pass-on by KPL) either (i) to terminate this Agreement insofar as it provides for the sale of New Gas to KPL hereunder, or (ii) to continue to receive the price being paid by KPL without giving effect to the increase; provided that the pricing provisions of this Agreement shall continue to be applicable thereafter regardless of Mesa's election to continue receiving such price."

Article I(e) also provided that if the KCC did not approve KP&L's request within sixty (60) days, the increased price was considered to be rejected. In the event of the KCC's failure to approve the increased price, KP&L had the option under the supplemental contract to pay the price requested by Mesa without KCC authorization. If KP&L refused to pay, Mesa had the option to terminate the contract.

On February 2, 1979, prior to the expiration of the KCC's sixty day approval period, KP&L filed a supplemental application. The KCC did not act on the application or the supplemental application within the sixty day approval period. The sixty day period ended February 5, 1979. KP&L did not elect to pay the increased price requested by Mesa. Mesa informed KP&L by letter on February 15, 1979, that Mesa was electing to exercise its option to terminate the supplemental contract. On February 16, 1979, Mesa filed the present suit in the Grant County District Court seeking a declaratory judgment to determine that it properly terminated the supplemental contract.

The district court entered its judgment in this case and ruled that Article I(b) of the supplemental contract was clear and unambiguous and reflected an intent on the

part of Mesa and KP&L to establish the maximum price allowed by the federal government through activation of the escalator clause in their contract. The court also concluded that Congress was a governmental authority that could succeed to the rate-making function of the Federal Power Commission within the meaning of Article I(b) of the contract.

However, the court further concluded under Article I (b) of the supplemental contract the price was not escalated under the terms of the escalator clause, and the correct maximum lawful price set by Section 105 (b) (1) of the N.G.P.Act was the price under the term of the existing contract on November 9, 1978, and not the Section 102 price as contended by Mesa. The plaintiff's prayer for a declaratory judgment was denied and it was determined that the supplemental contract entered into by the parties remained in full force and effect.

The single question raised in this appeal is whether the indefinite price escalator clause in the supplemental contract was triggered under Section 105 (b) (1) of the N.G.P.Act thus increasing the price to be paid under the intrastate contract to the Section 102 price. If the price was increased to the Section 102 price, Mesa was justified in terminating the supplemental contract and was entitled to the declaratory judgment. If the indefinite price escalator clause in the supplemental contract was not triggered under the N.G.P.Act the former contract price of $1.92 continued, and termination by Mesa was improper.

The provision of the N.G.P.Act which coordinates the transition from pricing under the Natural Gas Act to deregulation by maximum ceiling prices under the N.G.P. Act of 1978 is found in Section 601. 15 U.S.C. § 3431 (1979). With regard to the Natural Gas Act and the FERC, Section 601 of the N.G.P.Act states as follows:

> "[E]ffective on the first day of the first month beginning after November 9, 1978, [December 1, 1978] the provisions of the Natural Gas Act and the jurisdiction of the Commission [FERC] under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas."

Therefore, it appears that the old regulated prices were to continue under the Natural Gas Act up until December 1, 1978. On December 1, 1978, the new N.G.P. Act was to take over and the higher maximum ceiling prices on separate and distinct types of gas being produced would become the maximum possible ceiling prices.

Now let us examine the terms of Article I(b), the indefinite price escalator clause of the supplemental contract. It refers to any successor governmental authority which shall prescribe by law any price applicable to any natural gas sold in Kansas. Under the N.G.P.Act the FERC could no longer regulate the price of gas. Maximum prices were thereafter set by law for separate, distinct types of gas. The gas under the supplemental contract was being sold intrastate in Kansas. The gas prices had been depressed under federal and state regulation. It is reasonable to assume that the parties intended if Congress increased the maximum prices for which gas might be sold that this would fulfill the reference in Article I(b) to action by any successor governmental authority.

However, although the contract does say if the price prescribed by law is higher than the price then provided in Article I of the contract the price shall escalate to the regulated price, in the final sentence of Article I(b) it clearly states when the price is to be escalated under the contract. The escalation shall be either on the date the action of the governmental authority was taken (Novem-

ber 9, 1978), or the effective date of the law (December 1, 1978), *whichever is later.* Therefore, the price under the supplemental contract was to remain $1.92 per mcf until December 1, 1978.

We now turn to Section 105 (b) (1) of the N.G.P. Act which sets forth the method and procedure to determine the maximum lawful price allowed. It states the maximum lawful price under the section *shall be the lower of*—(A) the price under the terms of the existing contract to which the gas was subject on November 9, 1978, or (B) the maximum lawful price under Section 102 of the N.G.P.Act. The maximum lawful price under Section 105 (b) (1) was either the price under the terms of the existing contract on November 9, 1978 ($1.92 per mcf), or the maximum price under Section 102 of the N.G.P.Act for the month of December, 1978 ($2.078 per million BTU's), whichever is lower. Clearly the contract price on November 9, 1978, is the lower and remained the maximum lawful price under Section 105 (b) (1).

In its final brief filed in the district court Mesa argued the indefinite escalator clause was triggered by the payment of higher prices, not the enactment of the N.G.P.Act on November 9, 1978. In other words, the higher maximum prices were without doubt paid by some other purchasers and this triggered the raise to the price under Section 102 of the N.G.P.Act. We find nothing in the contract to support such an argument.

Mesa also argues the intention of the parties, when the indefinite escalator clause was inserted in the contract, was to provide the "highest price allowed by law." If that was so it could have been easily and clearly so written in place of the terms now appearing in the contract. Mesa seems to discount or overlook the statutory language as it applies to the specific language of the indefinite escalator clause in the supplemental contract.

The contract by its terms does not provide for price escalation upon enactment of the N.G.P.Act on November 9, but only on December 1. Price escalation on December 1, however, is no escalation at all for the maximum ceiling price can only rise to the lower of the two prices. The contract price on November 9 was the lower at $1.92 per mcf.

Since the indefinite price escalator clause in the contract was not triggered by the N.G.P.Act the attempted termination of the supplemental contract by Mesa was not lawful and Mesa remains bound by the terms of that contract.

KP&L in defense of its position has briefed and argued additional reasons for holding that the price of gas under the contract could not escalate to the Section 102 prices. Mesa in response and KP&L in defense of the lower court judgment have briefed further matters. These need not be addressed. What has been said disposes of this appeal.

The judgment of the district court is affirmed.

APPENDIX F

Not Designated for Publication

No. 52,885

MESA PETROLEUM COMPANY,
Appellant,

v.

THE KANSAS POWER AND LIGHT COMPANY,
Appellee.

MEMORANDUM OPINION

Appeal from Clark and Meade district courts; DON C. SMITH, judge. Opinion filed June 10, 1981. Affirmed.

Richard C. Byrd, of Anderson, Byrd & Richeson, of Ottawa, argued the cause, and *Walker A. Hendrix*, of the same firm, *Barry Cannaday*, of Mesa Petroleum Co., of Amarillo, Texas, and *David L. Patton*, of Patton, Gunderson & Kerbs, of Dodge City, were with him on the brief for the appellant.

Jerome T. Wolf, of Spencer, Fane, Britt & Browne, of Kansas City, Missouri, argued the cause, and *Basil W. Kelsey* and *Terry W. Schackmann*, of the same firm, *David S. Black*, general counsel for the Kansas Power and Light Company, and *Gene H. Sharp*, of Vance, Hobble, Neubauer, Nordling, Sharp & McQueen, P.A., of Liberal, were with him on the brief for the appellee Kansas Power and Light Company.

Terence L. Mundorf, of The Williams, Novack & Hansen Law Firm, of Everett, Washington, special counsel, argued the cause, and *Brian J. Moline*, general counsel, was with him on the brief for the appellee State Corporation Committee of the State of Kansas.

Per Curiam: Mesa Petroleum Company (Mesa) filed declaratory judgment actions in Clark and Meade Coun-

ties against the defendant Kansas Power and Light Company (KP&L), seeking determinations that Mesa legally terminated two gas supply contracts. The cases were consolidated for trial and the trial court held in favor of KP&L. Mesa appeals.

This consolidated action is a companion case to *Mesa Petroleum Co. v. Kansas Power & Light Co.* (No. 52,646, this day decided), arising from Grant County. The facts in the Grant County case are not substantially different from those in the case before us. Most importantly, the escalator clauses in the Clark and Meade County contracts are identical to the escalator clauses in the Grant County case in all significant respects. In the Grant County case we have this day held that the price escalator clause was not triggered by the establishment of maximum prices in the Natural Gas Policy Act of 1978 (15 U.S.C. § 3301 *et seq.* [1979]), and Mesa's attempted termination was therefore ineffectual. This determination is dispositive of the appeal herein and we do not reach the other issues raised.

The judgment is affirmed.

Not designated for publication.

APPENDIX G

THE SUPREME COURT OF THE STATE OF KANSAS

No. 80-52,646-AS

MESA PETROLEUM CO.,
Appellant,

v.

THE KANSAS POWER AND LIGHT COMPANY,
Appellee.

APPELLANT'S MOTION FOR REHEARING

Pursuant to Rule 7.06 of the Supreme Court Rules, Mesa Petroleum Co. ("Mesa") hereby moves for rehearing of the Court's opinion entered June 10, 1981, in the above referenced case.

INTRODUCTION

Mesa Petroleum Co. ("Mesa") respectfully submits that the interpretation placed upon Section 105(b)(1) of the Natural Gas Policy Act of 1978 ("NGPA") by the Kansas Supreme Court in this case irreconcilably conflicts with the case law of the Fifth Circuit, Congressional intent, and Federal Energy Regulatory Commission regulations. The decision of this Court should be set aside and the judgment of the lower court reversed for each and every one of the following reasons:

1. The Court's opinion is inconsistent with the interpretation of the NGPA by the United States Court of Appeals for the Fifth Circuit in the case of *Pennzoil Company, et al. v. FERC*, 645 F.2d 360 (5th Cir. May 20, 1981) (hereinafter *Pennzoil*). The proper interpretation of Section 105(b)(1) is set out in *Pennzoil* as follows:

> Under Section 105(b)(1), on the other hand, the maximum lawful price is the lower of the Section 102 or the current price under the existing intrastate contract (*rather than the November 9 price*). (Emphasis supplied, id at 376.)

2. The Court's opinion is inconsistent with the language of the NGPA and stated explanation of the NGPA set forth in the Statement of Managers which accompanied the legislation in Congress. The Court held that the NGPA Section 105(b)(1) maximum lawful price of the lower of the (a) price being paid under the contract on November 9, 1978 or (b) the Section 102 price. The NGPA and the explanatory material state that the price is the lower of (a) the price *under the terms* of the contract or (b) the Section 102 price.
3. The Court's opinion is inconsistent with the interpretation of the NGPA made by the Federal Energy Regulatory Commission ("Commission"): the agency solely empowered to administer the NGPA.
4. The Court's interpretation of Section 105(b)(1) causes the price under intrastate contracts to be frozen forever to the price in effect on November 9, 1978, if the price of the contract was less than the Section 102 price on said date. This interpretation if permitted to stand, eliminates all indefinite price escalations, fixed price escalations and totally frustrates the congressional policy underlying Section 105(b)(1).

The dispositive issue raised in this motion involves the Court's incorrect interpretation of the phrase "price under the terms of the existing contract" found in Section 105(b)(1). Both the District Court and this Court agreed that barring their interpretation of Section 105(b)(1), the price would have increased under the contract.

I. The Court's Opinion in this Case is in Direct Conflict with the Fifth Circuit Decision in *Pennzoil*

The Fifth Circuit in *Pennzoil* construed many portions of the NGPA. It discussed the proper interpretation of Section 105(b)(1), stating:

> Under Section 105(b)(1), on the other hand, the maximum lawful price is the lower of the Section 102 price or the current price under the existing intrastate contract (*rather than the November 9 price*). Emphasis supplied, 645 F.2d supra at 376.

With these words, the Fifth Circuit correctly recognized that the maximum lawful price under Section 105(b)(1) was not established by the November 9, 1978 contract price, but rather by the terms of the contract as they existed on November 9, 1978. The Fifth Circuit acknowledged that the price under a 105(b)(1) contract could escalate by its terms up to the Section 102 ceiling price. It stated:

> If the contract has an escalation provision, definite or indefinite, it may increase the contract price up to but not in excess of the Section 102 price, and then can escalate only at the statutory inflation and real growth adjustment rates. *Id.*[1]

The Fifth Circuit also recognized that the price escalation provisions of a 105(b)(1) contract, such as Mesa's contract, permitted an increased price up to the Section 102 price after November 9, 1978, if those price escalation provisions were a part of the contract on the November 9th date. The Fifth Circuit, relying in part on Congressman Dingell's explanation of Section 105, stated:

> First, Congress knew how to codify existing contract prices as maximum lawful prices when it meant to do so. Section 105 and 106(b) apply to

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[1] On rehearing, this quotation was changed to read as follows: "If the contract has an escalation provision, definite or indefinite, it may authorize collection of prices up to but not in excess of the section 102 price, and then can authorize collections only of prices equal to the statutory inflation and real growth adjustment rates.

gas under an intrastate contract that was in effect on the N.G.P.A.'s date of enactment. These are the only N.G.P.A. provisions that expressly make the contract price the maximum lawful price. If the contract price on November 9, 1978, was greater than the section 102 new gas price, then under section 105(b)(2) the maximum lawful price is the November 9th contract price until the section 102 price catches up to the inflation adjusted contract price. *If, on the other hand, the price on November 9th was less than section 102, under section 105(b)(1) the maximum lawful price is the current price provided for under the terms of the contract as long as it does not exceed the section 102 price. Therefore, in the latter case, the intrastate contract price may escalate from its November 9th level to the section 102 level, provided that the contract has a sufficient escalation mechanism. . . .*

Congress thus codified intrastate prices existing on November 9th if higher than section 102, but codified the "*contract schedule of prices or contract mechanisms for establishing prices over time*" *subject to the cap of section 102 if the November 9th price was less than section 102.* 124 Cong. Rec. H13117 (daily ed. Oct. 14, 1978) (statement of Rep. Dingell) (emphasis in original). *This elaborate incorporation of either the contract price or the contract escalation provisions into the maximum lawful price would have been totally unnecessary if section 101(b)(9) froze existing November 9th contract prices.* (Emphasis supplied, id. 374-5.)

As noted by the Fifth Circuit, had the Congress intended to fix the November 9, 1978 contract price as the maximum lawful price under Section 105(b)(1) of the NGPA, it could have done so easily. Congress could have dispensed with the two subcategories for intrastate contracts, and simply provided that the maximum lawful price for intrastate contracts was the contract price on

the date of enactment. However, the Congress did not so provide, and the Kansas Supreme Court therefore erred by reading Section 105(b)(1) as restricting an intrastate contract to the contract price on November 9, 1978.

II. The Court's Opinion is inconsistent with the language of the NGPA and the stated explanation of the NGPA

Section 105(b)(1) is the touchstone of the controversy between Mesa and The Kansas Power and Light Company ("KPL"). Section 105(b)(1) simply establishes the maximum lawful price for intrastate contracts whose contract price on November 9, 1978 was equal to or less than $2.078 per MMBtu. Section 105(b)(1) provides:

> (b) MAXIMUM LAWFUL PRICE.—
>
> (1) GENERAL RULES.—Subject to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of—
>
> (A) The price under the terms of the existing contract, to which such natural gas was subject on the date of the enactment of this Act, as such contract was in effect on such date; or
>
> (B) The maximum lawful price, per million Btu's, computed for such month under Section 102 (relating to new natural gas).

It is fundamental to note that price determination under Section 105(b)(1) is based on the phrase "price under the terms of the existing contract," and not the phrase "contract price." There exists a crucial and recognizable distinction between these phrases. Although the Kansas Supreme Court appears to rely upon the definition of "contract price" as set out in Section 105(c)(1) in reaching its decision, the phrase is a defined term which is

not used in Section 105(b)(1), and has *no* direct application to this controversy as the Court's opinion appears to indicate.

Both the District Court and this Court have construed the phrases "price under the terms of the existing contract" and "contract price" as synonymous. This is apparent in the Court's analysis of Section 105(b)(1) where it states "the maximum lawful price under Section 105(b)(1) was either the price under the terms of the existing contract on November 9, 1978 ($1.92 per mcf), or the maximum lawful price under Section 102 of the N.G.P. Act for the month of December, 1978 (2.078 per million BTUs), whichever is lower." Slip opinion at 10. As noted, this construction is mistaken and irreconcilable with the statute's legislative history, Commission interpretation and the *Pennzoil* decision.

The phrase "contract price" has two functions in Section 105. The first function is to determine whether a contract is subject to Section 105(b)(1) or Section 105(b)(2). Secondly, "contract price" is used in Section 105(b)(2) to determine the maximum lawful prices for contracts where the "contract price" exceeded the Section 102 price on the date of enactment of the NGPA. The phrase "contract price" is absent from the provisions of Section 105(b)(1)—the provisions that govern the Mesa-KPL contract—and was not intended to have any application in the determination of maximum lawful prices under Section 105(b)(1).

Instead of "contract price," Congress used the phrase "price under the terms of the existing contract" to compute the maximum lawful price under Section 105(b)(1). The phrase "price under the terms of the existing contract" refers to the pricing mechanism under the contract as of November 9, 1978, and not to the November 9, 1978 contract price. This is made clear by Congressman

Dingell in his explanation on the operation of Section 105(b)(1) when he stated:

> The ceiling price mechanism under Section 105(b)(1) is based upon "the terms of the existing contract . . . in effect on [date of enactment Section 105(b)(1)]". This phrase must be distinguished from the phrase "contract price" used in Section 105(b)(2). The latter is date specific, referring to the price paid under the contract for gas deliveries on date of enactment. The phrase "the price under the terms of the . . . contract" used in Section 105(b)(1) refers to the contract schedule of prices or contract mechanism for establishing prices over time. This schedule or mechanism is given effect with the single limitation that the price so established may not exceed the new gas ceiling price established under Section 102. *The contract price terms in effect on date of enactment would then be honored up to the new gas ceiling price.* (Emphasis supplied, 124 Cong. Rec. H13117 (Oct. 14, 1978).)

The effect of this deliberate use of the term "price under the terms of the contract" rather than "contract price" in Section 105(b)(1) is to allow the pricing mechanism under the contract to take place subsequent to November 9, 1978, subject only to the limitation established by the Section 102 price. As noted by the House and Senate Managers of the NGPA:

> The maximum lawful price (under Section 105) depends upon the contract price in effect on the date of enactment of this Act. If the contract price in effect on the date of the enactment is less than the new gas ceiling price, the maximum lawful price for any subsequent month is the lower of (1) the price under the terms of the existing contract in effect on the date of enactment, or (2) the new gas

> price. *Thus, the price under the contract may escalate through the operation of both fixed price escalator clauses and indefinite price escalator clauses in existence as of the date of enactment, but the price may not exceed the new gas price.* (Emphasis supplied, H.R. Rep. No. 95-1752, 95th Cong. 2d Sess. 82 (1978).)

This statement by the Managers makes it absolutely clear that Congress mandated that the "terms of the contract" (which is not the same as "contract price") be allowed to operate and prices be increased thereby, subject only to the limitations established by the Section 102 price.

III. The Court's opinion is in conflict with the Interpretation of the NGPA by the Commission

The Commission has followed Congressional mandate in establishing regulations implementing the NGPA. The Commission's regulations provide that for contracts subject to Section 105(b)(1):

> The maximum lawful price for natural gas delivered in any month shall be the lower of:
>
> (1) the price for such month under the terms of the existing intrastate contract to which such natural gas was subject on November 9, 1978, as such contract was in effect on November 9, 1978; or
>
> (2) the maximum lawful price per MMBtu for such month specified for new natural gas (subpart B of part 271) in table 1 of § 271.101(a).

18 CFR § 271.502(a). These regulations were implemented only after some initial confusion caused by the Commission's incorrect usage of the term "contract price" in place of the term "price under the term of the contract." The Commission corrected its error noting:

> Comments were received from various parties concerning our use of the phrase "contract price" in § 271.502(a)(1). They asserted that its use in that paragraph caused confusion as to whether future contractually authorized fixed or indefinite price escalator clauses, including price redetermination provisions, operate to effect price increases. The commentors fear that an interpretation more restrictive than required by the legislation would apply in the case of § 271.502(a)(1). One commentor, therefore, suggested that § 271.502(a)(1) be revised to track the statutory language in Section 105(b)(1)(A) of the NGPA to refer to the "price under the terms of the existing contract." We agree and we have revised § 271.502(a)(1) to track the appropriate statutory language. This change should allay the apprehensions of those commentors who feared that fixed or indefinite price escalator clauses in contracts were abrogated by § 271.502(a)(1). (Federal Energy Regulatory Commission, Interim Regulations implementing The Natural Gas Policy Act of 1978, 43 F.R. 56448, CCH Vol. II, Paragraph 30,062, at 30,162 (December 1, 1978).)

The Commission's regulations thus provide that the contract price may escalate in accordance with contract terms, subject to the cap established by the Section 102 price. These regulations are perfectly consistent with the provisions of the NGPA and the Fifth Circuit determination in *Pennzoil.*

IV. The Court's Opinion Eliminates all Indefinite and Fixed Price Escalators and Frustrates Congressional Policy

The foregoing discussion makes it clear that the proper operation of Section 105(b)(1) requires that the contract escalate according to its provisions, subject only

to the limitations established by Section 102. The Court's interpretation of Section 105(b)(1) simply would not allow the contractually authorized schedule of price increases to occur under this contract or under any other contract subject to Section 105(b)(1). Rather, the Court's interpretation of Section 105(b)(1) establishes the maximum lawful price under the Mesa-KPL contract as $1.92 per MMBtu, which price may not be escalated during the life of the contract.

A hypothetical example using a contract with a fixed escalator clause will illustrate the error of the Court's interpretation. Assume there is an existing intrastate contract that on November 9, 1978 had a contract price of $.50 per MMBtu. Assume further that the only escalation provided for in the contract is a fixed escalator clause that provides for a $.25 per MMBtu escalation per year, effective upon the first day of each calendar year. Under the Court's interpretation of Section 105(b)(1) the following results would occur. First, the "contract price" as of November 9, 1978 would be $.50 per MMBtu. Second, since the Court mistakenly construes "contract price" on November 9, 1978 as being the same as the "price under the terms of the contract," the lower of the "price under the terms of the existing contract" and the 102 price always would be $.50 per MMBtu. This result would follow regardless of the fact that there were fixed, definite price increases due the Seller each year, increases that would not cause the contract price to exceed the Section 102 price. This hypothetical demonstates the mistake this Court has made in its interpretation of Section 105(b)(1) by not allowing contractually authorized escalations to take place. It also illustrates that under the decision in this case, no contract price could ever escalate under Section 105(b)(1).

Under the proper and correct interpretation of Section 105(b)(1), the results of the hypothetical example

would be as follows. On the first day of the next calendar year, the price under the contract would escalate to $.75 per MMBtu. The only limitation established by Section 105(b)(1) is that the price received by the seller may not exceed the Section 102 price. This interpretation and the escalation thereunder comports with the intent of Congress, the Commission's regulations and the standards set forth by the Fifth Circuit in *Pennzoil.*

The Congress prescribed three prices for natural gas in the NGPA, which became effective on December 1, 1978, that were higher than the price then existing under Mesa's contract. The three prices were the Section 102 new gas price ($2.078 per MMBtu), Section 103 onshore production price ($1.969 per MMBtu) and the Section 108 stripper price ($2.224 per MMBtu). 18 CFR § 271.101. Because Mesa's contract is not limited to intrastate gas for escalation, but includes a reference to interstate gas, and because the contract makes reference "to any natural gas of any vintage produced from the Hugoton-Andarko area," Mesa under its contract was entitled to the Section 108 price of $2.224 per MMBtu on December 1, 1978.

Because of the limitations imposed by Section 105(b)(1), (i.e., the maximum lawful price is the lower of the price permitted under the terms of the contract or the monthly Section 102 price), Mesa did not claim the Section 108 price ($2.224 per MMBtu on December 1, 1978), but rather made demand for the Section 102 price ($2.078 per MMBtu on December 1, 1978). Whether the contract authorized the Section 102 or 108 price was insignificant insofar as Section 105(b)(1) established the Section 102 price as the highest price that could be collected under an intrastate contract. Correspondingly, Mesa did not seek the Section 103 price ($1.969 per

MMBtu on December 1, 1978) under the contract even though it was higher than the contract price, because the Section 102 price offered a higher price which could be collected under Section 105(b)(1).

The Court has held that despite the breadth of the Government Price Regulation clause, Section 105(b)(1) prevents escalation. The Court reaches its decision by erroneously construing the time reference in Section 105(b)(1), i.e., November 9, 1978, as modifying the word "price" rather than the phrase "terms of the contract." The Court reads Section 105(b)(1) as if it said "the price on [November 9, 1978] under the terms of the contract" rather than "the price under the terms of the existing contract . . ., as such contract was in effect on such date." The reason Congress established the time limitation was to prevent parties from modifying their contracts after November 9, 1978 to insert escalation provisions that would circumvent the maximum lawful prices established by Congress. Congress intended that the agreements struck between Buyers and Sellers prior to November 9, 1978 remain in place, and that the parties be able to enjoy the benefits of the bargain, limited only by the Section 102 price. Thus, existing contract terms were allowed to operate, but parties were bound by those terms as the terms were in effect on November 9, 1978.

The Court's interpretation of Section 105(b)(1) will operate in a totally opposite manner. Under the Court's interpretation, existing price provisions do not operate at all. Not only are parties prevented from amending their contracts to provide for higher prices, they are prevented from relying on specific rate increases established by their contracts. Such a result, if correct, would be patently unconstitutional. It is also ironic that the Court's decision would prevent any form of escalation for the lower priced 105(b)(1) natural gas, while Section 105

(b)(2) permits the price for higher priced natural gas to increase for inflation and growth.

In KPL's letter to the Court dated June 8, 1981, KPL suggests that footnote 32 of the *Pennzoil* decision would preclude escalation in this case. Footnote 32, which is currently the subject of requests for rehearing, states that legislative rate clauses would not be permitted to operate. A legislative rate clause is a clause that turns back on itself because it relies on Section 105(b)(1) as the only basis for triggering under the contract. Since Article 1(b) of the Mesa-KPL Contract provides for price increases by the way of reference to Section 102, 103 and 108 of the NGPA, it cannot be seriously contended that Article 1(b) turns back on itself for purpose of escalation. It is the price prescribed under Section 102, 103 and 108 which caused the Governmental Price Regulation Clause to trigger, not Section 105(b)(1). There is absolutely no "boot strap" effect as referenced in footnote 32 of the *Pennzoil* decision, to which KPL alluded in its letter to this Court dated June 8, 1981.[2]

CONCLUSION

In view of the *Pennzoil* decision, the NGPA and its legislative history and Commission rules and regulations, the Court's decision should be reconsidered. As it stands, the Kansas Supreme Court has interpreted a federal statute contrary to a federal court and the federal agency empowered to enforce the NGPA. It has also interpreted Section 105(b)(1) as nullifying contract terms, when the whole philosophy surrounding natural gas pricing was to give deference to contract terms and their operation. Mesa submits that the operative terms of its contract on November 9, 1978 permitted escalation to the Section 102 price when it became effective on December 1, 1978. For this reason, Mesa prays that the

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[2] The portion of footnote 32 discussed in KPL's letter to the Court dated June 8, 1981 and that was the subject of this paragraph, was deleted by the Fifth Circuit on rehearing.

Court grant its motion for rehearing, and upon rehearing, the decision of this Court to be set aside and the judgment of the lower court be reversed.

Respectfully submitted:

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[Certificate of Service Omitted in Printing]

APPENDIX H

No. 52,646

MESA PETROLEUM COMPANY,
Appellant.

v.

THE KANSAS POWER AND LIGHT COMPANY,
Appellee.

OPINION ON MOTION FOR REHEARING

Appeal from Grant district court, KEATON G. DUCKWORTH, judge. Opinion filed July 17, 1981, clarifying opinion filed June 10, 1981, and denying rehearing.

Richard C. Byrd and *Walker A. Hendrix*, of Anderson, Byrd & Richeson, of Ottawa, *E. F. Russell*, of Ulysses, and *Barry Cannaday* and *Jeffrey G. Shrader*, of Amarillo, Texas, were on the brief for the appellant.

Jerome T. Wolf, *Basil W. Kelsey* and *Terry W. Schackmann*, of Spencer, Fane, Britt & Browne, of Kansas City, Missouri, *Gene H. Sharp*, of Vance, Hobble, Neubauer, Nordling, Sharp & McQueen, P.A., of Liberal, *David S. Black*, of Topeka, and *James L. Grimes, Jr.*, of Cosgrove, Webb & Oman, of Topeka, were on the brief for the appellee.

A. J. Schwartz, of Morris, Laing, Evans, Brock & Kennedy, of Wichita, and *C. J. Roberts*, *Larry Pain*, and *Jennifer A. Cates*, of Bartlesville, Oklahoma, were on the *amicus curiae* brief for Phillips Petroleum Company.

Charles J. Woodin, of Foulston, Siefkin, Powers & Eberhardt, of Wichita, was on the *amici curiae* brief for Petroleum, Inc., Pickrell Drilling Company, McCoy Petroleum Company, and KIOGA.

John E. Robertson, of Denver, Colorado, and *Jack D. Sage* and *Richard Jones*, of Hershberger, Patterson, Jones & Roth, of Wichita, were on the *amicus curiae* brief for Mobil Oil Corporation.

R. H. Landt, of Denver, Colorado, and *Glenn D. Young, Jr.*, of Gott, Young & Bogle, P.A., of Wichita, were on the *amicus curiae* brief for Amoco Production Company.

Joseph W. Morris, of Houston, Texas, and *John F. Jones*, of Ottawa, were on the *amicus curiae* brief for Shell Oil Company.

Thomas A. Loftus, III, of Houston, Texas, and *Winston A. Winter, Jr.*, of Stevens, Brand, Lungstrum, Golden & Winter, of Lawrence, were on the *amicus curiae* brief for Gulf Oil Corporation.

The opinion of the court was delivered by

FROMME, J.: Mesa Petroleum Company, appellant, filed a Motion for Rehearing in this case. Various other gas companies as friends of this court sought and obtained permission to file briefs in support of appellant's Motion for Rehearing. Their concerns are twofold: first, they are concerned with certain terminology used in the original opinion and second, they contend the ultimate decision of this court was erroneous. The Kansas Power and Light Company responded to these concerns urging that rehearing be denied and our opinion be confirmed.

In the original opinion we held (1) the indefinite price escalator clause contained in the gas purchase contract between the parties was not triggered by enactment of the Natural Gas Policy Act of 1978 (15 U.S.C. § 3301, *et seq.* [1979]), (2) the contract price was not escalated, and (3) the attempted termination of the contract by Mesa was ineffective.

It is contended by movants that our opinion went beyond these holdings and is, in fact, contrary to the hold-

ing in *Pennzoil Co. v. Federal Energy Regulatory Com'n*, 645 F.2d 360 (5th Cir. 1981). We do not agree. The issue in *Pennzoil* was:

> "May 'area rate clauses' in existing interstate gas purchase contracts escalate the contract price to the maximum lawful price provided in the Natural Gas Policy Act of 1978?" p. 365.

The circuit court stated:

> "The text of the statute itself, its legislative history, and the structure and policy of the NGPA do not preclude area rate clauses from escalating the interstate contract price to the maximum lawful NGPA price. *Nor does it, on the other hand, require such escalation.*" p. 372. Emphasis supplied.

Referring to the setting of ceiling prices discussed in Section 105(b)(1) the court pointed out:

> "If, on the other hand, the [contract] price on November 9th was less than section 102, under section 105 (b)(1) the maximum lawful price is the current price provided for under the terms of the contract as long as it does not exceed the section 102 price. Therefore, in the latter case, the intrastate contract price may escalate from its November 9th level to the section 102 level, *provided that the contract has a sufficient escalation mechanism.*" pp. 374-75. Emphasis supplied.

As we interpret the N.G.P.Act it does not preclude escalation of prices under contract clauses up to N.G.P. Act ceiling prices. On the other hand, contrary to the assumption by Mesa, the mere enactment of the N.G.P.Act did not activate price escalator clauses, such as the one in the present case, so as to escalate prices to the N.G.P.Act ceiling levels.

We adhere to our original decision that the price of gas under the terms of the contract between the parties

did not escalate to the N.G.P.Act ceiling price merely because the N.G.P.Act was passed and became law. The contract provides for escalation if and when a governmental authority shall "prescribe by law" any price which is higher. Any escalation in price under the contract is to take effect as of the date the authority establishes the regulated price.

Under the N.G.P.Act no regulated price is established. With the change in the law from regulated pricing under the Natural Gas Act to deregulation under the N.G.P.Act by setting ceiling prices, a different concept appeared. Prices were not prescribed by law. They were permitted to escalate under the terms of the various contracts not to exceed certain ceiling prices provided for in the N.G.P.Act. Provisions in these contracts for definite and indefinite escalation of prices and for redetermination of prices by later agreement are not nullified by the Act. However, these are limited by the terms and conditions agreed to by the parties in the contracts. In our present case, the contract as drawn by the parties did not provide for payment of the highest price allowed by law and this court will not rewrite the contract to authorize that result.

Accordingly, we decline to grant a rehearing; the original opinion of the court is clarified as set forth herein. We adhere to the original opinion except as herein clarified.

APPENDIX I

IN THE SUPREME COURT OF
THE STATE OF KANSAS

No. 81-52885-AS

MESA PETROLEUM COMPANY,
Appellant,

v.

KANSAS POWER AND LIGHT CO.,
Appellee.

You are hereby notified of the following action taken in the above entitled case:

Appellant's Motion for rehearing.

CONSIDERED AND DENIED.

Yours very truly,

LEWIS C. CARTER
Clerk, Supreme Court

Date July 17, 1981

APPENDIX J

No. 52,677

ENERGY RESERVES GROUP, INC.,
Appellant,
v.
KANSAS POWER AND LIGHT COMPANY,
Appellee.

SYLLABUS BY THE COURT

1. In determining whether a particular clause in a gas purchase contract authorizes increased rates, courts should endeavor to ascertain and give effect to the intent of the parties to the contract.

2. Under the contract clause of the U.S. Constitution (Art. I, § 10, cl 1), prohibiting state impairment of contract obligations, legislation adjusting the rights and responsibilities of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption.

3. In reviewing economic and social legislation against Contract Clause challenges, courts should defer to the legislature's judgment of the necessity and reasonableness of a particular measure.

4. The Kansas Natural Gas Price Protection Act, K.S.A. 1980 Supp. 55-1401 *et seq.*, is a reasonable and appropriate regulation of the natural gas industry; it is not unconstitutional under the contract clause of the United States Constitution, Article I, Section 10, Clause 1.

5. In a declaratory judgment action involving the construction of indefinite price escalator clauses in natural gas purchase contracts, the record is examined and it is held: 1) the parties intended that price increases under the contract would be triggered by legislation such as the

Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*; 2) whether the price of natural gas increases under a certain contract is dependent upon the specific terms of that contract; 3) the contract provisions here involved were not effective to permit price escalation under § 105 of the Natural Gas Policy Act; 4) certain clauses in the contracts were "indefinite price escalator clauses" as defined by the Kansas Natural Gas Price Protection Act; and 5) the Kansas Natural Gas Price Protection Act is constitutional.

Appeal from Harper district court, division No. 2; CHAS. H. STEWART, judge. Opinion filed July 17, 1981. Affirmed.

Gary W. Davis, of Martin, Pringle, Fair, Davis & Oliver, of Wichita, argued the cause, and *Martin W. Bauer*, of the same firm, and *Clark Mandigo*, general counsel for Energy Reserves Group, Inc., were with him on the brief for the appellant.

Jerome T. Wolf, of Spencer, Fane, Britt & Browne, of Kansas City, Missouri, argued the cause, and *Basil W. Kelsey* and *Terry W. Schackmann*, of the same firm, *David S. Black*, general counsel, for the Kansas Power and Light Company, and *William C. Farmer*, of Smith, Shay, Farmer & Wetta, of Wichita, were with him on the brief for the appellee.

Brian J. Moline, general counsel, and *Terence L. Mundorf*, assistant general counsel, were on the brief *amicus curiae* for the State Corporation Commission of the State of Kansas.

Robert L. Howard, of Foulston, Siefkin, Powers & Eberhardt of Wichita, was on the brief *amicus curiae* for Kansas Independent Oil and Gas Association.

The opinion of the court was delivered by

MILLER, J.: This is a declaratory judgment action involving the construction of the terms of two natural

gas purchase contracts in the light of certain federal and state statutes.

The plaintiff, Energy Reserves Group (ERG), brought suit against the defendant, Kansas Power & Light Company (KPL), seeking judgment that ERG had the right to terminate the contracts. KPL by counterclaim, sought judgment that it had committed no breach, and that ERG had no right to terminate the contracts. Upon an extensive documentary record, both parties moved for summary judgment. The trial court denied ERG's motion and granted that of KPL; ERG appeals.

The two gas purchase contracts in issue were executed on September 27, 1975, by Clinton Oil Company, predecessor of ERG, and KPL. One was a contract for the sale of gas produced directly from the wells; the other was a residue gas purchase contract for the sale of remaining gas after certain recovery and processing steps were completed. Under the contracts, KPL agreed to purchase natural gas for the life of the Spivey-Grabbs field, located in Harper and Kingman counties, or for the life of the processing plants associated with the field. All the gas involved was produced and sold within the state of Kansas and thus was intrastate gas.

Each contract contains identical provisions relating to government price escalation, price redetermination, commission approval, and intent. These contract provisions are as follows:

The Government Price Escalator Clause

> "6.7 If any federal or Kansas regulatory or governmental authority having jurisdiction in the premises shall at any time hereafter fix a price per MCF applicable to any natural gas of any vintage produced in Kansas, higher than the contract price then in effect under this gas contract, the price to be paid for gas thereafter shall be increased to equal such

regulated price. In that event, the increased price shall be effective as of the date of action of the government or regulatory authority establishing the regulated price, or its effective date, whichever is later, subject to the provisions of Section 8 hereof."

Price Redetermination

"7.1 SELLER shall have the option to cause the price being paid for its gas by BUYER to be redetermined every two years, beginning in 1977. The request for a price redetermination shall be given in writing by SELLER to BUYER not later than 120 days prior to the beginning of the Contract Year for which the price redetermination is requested. Should such request not be given within the required time, SELLER shall be deemed to have waived its option for that two-year period only. The effective date of any price established by price redetermination shall be the beginning of the Contract Year, subject however, to the provisions of Section 8 hereof.

"7.2 Within the same one hundred twenty (120) days following SELLER'S request for a price redetermination, the parties shall mutually redetermine the price by considering three (3) contracts under which the highest prices are actually being paid for flowing gas ninety (90) days prior to the date the redetermined price is to be effective. The contracts to be considered shall, (a) have a primary term of one (1) or more years, (b) be for gas produced in Kansas, (c) be for gas purchased by an interstate or intrastate company selling or using an average daily volume of 5,000 MCF or more of gas for the twelve (12) months period ending ninety (90) days prior to the date the redetermined price is to be effective, (d) not be for the purchase of Spivey-Grabs Field gas by BUYER under contracts dated in 1975, (e) not include more than one contract of any

one purchaser in any one field, and (f) not be for a price then subject to regulatory suspense or refunds. In determining the 'highest prices' being paid, and as they may apply to a fair market price under this contract, BUYER and SELLER shall make valid adjustments in pricing considerations, including but not limited to the heating value of the gas, and costs of gathering, compression and processing rights."

Commission Approval

"8.2 BUYER shall make application to the Kansas Corporation Commission for approval of the pass-on of any of such increased costs of gas not later than sixty (60) days prior to the date the applicable increase is scheduled to become effective, or within five days after the increase has been established by arbitration or by action of governmental or regulatory authorities. The failure of the Kansas Corporation Commission to approve a pass-on within sixty days after application by BUYER shall be deemed a rejection of the price increase for the purposes of this gas contract.

"8.3 BUYER shall have the option, to be exercised by written notice to SELLER not later than fifteen (15) days after the Kansas Corporation Commission shall have rejected any such pass-on, to pay the increased price and in such event the provisions of this gas contract shall remain in effect. If BUYER does not elect to pay such increase then SELLER shall have the option to terminate this gas contract on thirty days prior written notice."

The Intent Clause

"23.1 It is the intention of the parties that the price adjustment provisions contained herein are solely for the purpose of compensating SELLER for the anticipated increase in its operating costs and

for the anticipated increase in the value of its Natural Gas to be sold hereunder. It is understood that no price escalation, price redetermination or other pricing provision of this gas contract is for the purpose of offsetting any potential increase in SELLER'S Federal income tax liability as a result of the repeal of percentage depletion."

ERG invoked the price redetermination clause in 1977, and on November 27, 1977, the parties mutually accepted a price of $1.77 per MCF. This redetermined price was approved by the Kansas Corporation Commission and was the price paid by KPL during the calendar year 1978.

On November 9, 1978, congress passed the Natural Gas Policy Act (NGPA), 15 U.S.C. §§ 3301-3432. This act (1) terminates the authority of the Federal Energy Regulatory Commission (FERC), successor to the Federal Power Commission, to prescribe rates for natural gas, and (2) establishes short term ceiling prices for various categories of natural gas. The sections of the act with which we are most concerned are as follows:

§ 2 (15 U.S.C. § 3301) is the definitions section.

It defines "new well" as any well drilled after February 19, 1977, or the depth of which was increased by drilling after that date. It also defines "first sale" as any sale of natural gas "to any person for use by such person."

§ 102 (15 U.S.C. § 3312) fixes the maximum lawful price for new natural gas. (The Section 102 price for new natural gas for the month of December 1978 was $2.078 per million BTU's.

§ 105 (15 U.S.C. § 3315) fixes the ceiling price for gas sales under existing intrastate contracts. Subsection (b) (1) reads as follows:

"(b) Maximum lawful price

"(1) General rule

"Subject to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of—

"(A) the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date; or

"(B) the maximum lawful price, per million Btu's computed for such month under Section 3312 of this title (relating to new natural gas)."

§ 601 (15 U.S.C. § 3431) terminates the authority of the FERC to prescribe rates for both intrastate and interstate natural gas, beginning December 1, 1978. (The rates previously fixed by the Commission are left operative until that date.)

§ 602 (15 U.S.C. § 3432) provides that nothing in the NGPA "shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed" the maximum ceiling price fixed by the act.

On November 20, 1978, ERG notified KPL by letter that the gas price would increase on December 1, 1978, to the Section 102 price.

On December 1, 1978, the FERC announced interim regulations, one of which, effective on that date, provided that "(T)he establishment of maximum lawful prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate or interstate contracts." 43 Fed. Reg. 56448, 56550 § 270.205 (a) (Interim Regulations 1978).

KPL petitioned the KCC on December 7, 1978, for pass-through approval of the Section 102 rates demanded by

ERG. KPL filed a supplemental petition relating to the pass-through of these increased prices on February 2, 1979. Seventy-five days from KPL's December 7th application was February 20, 1979.

On February 13, 1979, the FERC issued a notice of proposed changes in its rules; the interim regulations were continued in full force and effect during the comment period. 44 Fed. Reg. 16896 (March 20, 1979). The FERC, on March 13, 1979, issued Order No. 23, which withdrew the prohibition of the operation of indefinite price escalator clauses, retroactive to December 1, 1978. The Order reserves to State law the determination of whether such clauses operate in intrastate contracts. 44 Fed. Reg. 16895, 16904 (March 20, 1979).

Next in the series of events was the enactment by the Kansas legislature of the Kansas Natural Gas Price Protection Act, K.S.A. 1980 Supp. 55-1401 *et seq.* (which we shall refer to as the Kansas Act or the Price Protection Act), which became effective upon its publication in the official state paper on May 29, 1979. Some of the salient features of this act are as follows:

> 55-1402 defines "gas purchase contract" as "any contract under which natural gas is sold within the state of Kansas . . . (2) to any person for use by such person . . ." and it defines "indefinite price escalator clause" as "any provision of a gas purchase contract which provides for the establishment or adjustment of the price of natural gas delivered under such contract by reference to other prices for natural gas. . . ."
>
> 55-1403 provides that the act shall apply only to contracts entered into before April 20, 1977.
>
> 55-1404 restricts the operation of indefinite price escalator clauses. With certain exceptions, it provides that "[O]n or after December 1, 1978, the price allowed to be paid pursuant to federal legis-

lation or any regulation by an agency implementing such legislation, or the price paid or to be paid for any sale of natural gas in the state of Kansas shall not be taken into account in applying any indefinite price escalator clause contained in any gas purchase contract subject to this act, to the extent that such contract provides for the sale in the state of Kansas, of gas produced within this state which was not committed or dedicated to interstate commerce on November 8, 1978. This section shall not require a reduction of any price contained in any gas purchase contract subject to this act below the price actually paid prior to the date of enactment of this act."

55-1408 provides that this act shall not limit the voluntary renegotiation of price provisions contained in natural gas purchase contracts.

55-1411 declares that the price limitations defined in this act shall terminate not later than December 31, 1984.

ERG, by letter dated June 5, 1979, notified KPL of its intent to terminate the contracts in thirty days, on July 5, 1979, based on (1) the failure of KPL to make application to the KCC for pass-on authority within five days of December 1, 1978, (2) the failure of KPL to obtain KCC approval for the payment of the Section 102 price, and (3) the failure of KPL to pay the increased price. ERG contended that the pricing provisions of the NGPA triggered the government price escalation clause, § 6.7 of the contract, and that ERG was therefore entitled to the Section 102 price. KPL responded on June 13, 1979, denying that the government price escalator clause was triggered by the NGPA, claiming that 55-1404 of the Price Protection Act prevents the operation of the escalator clause, and further contending that KPL had not violated the contract and ERG had no right to terminate the contracts.

ERG filed its petition in the district court of Harper County on July 2, 1979, seeking a declaratory judgment that it had the right to terminate the contracts on the grounds set forth in its June 5, letter.

Next, on July 24, 1979, ERG wrote letters to KPL requesting that the price being paid under both contracts be redetermined under the price redetermination clauses of the contracts (§ 7, quoted above). KPL responded on July 27, stating in effect that K.S.A. 1980 Supp. 55-1404, a part of the Price Protection Act, prevents the operation of the price redetermination clauses in the contracts; therefore KPL could not agree to the requested price redetermination.

ERG than [sic] filed an amended petition in the trial court, including the claim that it was entitled to terminate the contracts because of KPL's refusal to renegotiate the price pursuant to the price redetermination clauses in the contracts. KPL answered, and also filed a counterclaim in which it sought a declaratory judgment that it had not breached the contract, that the contracts were still in effect, and that ERG had no lawful right to termination. Both parties attached to their pleadings copies of the contracts and of correspondence exchanged between them; both moved for summary judgment. Additional documents and affidavits were supplied the court in connection with those motions, and the parties agreed that the facts were not in dispute.

After extensive oral argument and the submission of briefs, the trial court issued a lengthy and detailed memorandum opinion on April 11, 1980, ruling in substance: (1) that the governmental price regulation clauses in the contracts were intended to apply to rates fixed by a regulatory authority, and that such rates are distinguishable from ceiling prices established by the NGPA; (2) that the NGPA did not trigger the indefinite price escalator clauses in the contracts; (3) that the parties may volun-

tarily renegotiate prices, but that ERG cannot have an automatic increase under either the government price escalator clause or the price redetermination clause for the reason that such price escalation is prohibited by the Kansas Price Protection Act; (4) that the case cannot be decided without determining the constitutionality of the Kansas act; and (5) that the Kansas act does not violate the contract clause of the United States Constitution. The court denied ERG's motion for summary judgment, and sustained that of KPL. ERG appeals.

The first point raised is that the trial court erred in finding that the government price escalation clauses in the contracts were not intended to be triggered by enactments such as the NGPA. ERG's principal contention on this issue is that the trial court utilized far too narrow an analysis of the government price redetermination clauses; ERG claims that if the court had examined the intent of the parties, it would have concluded that the NGPA was the kind of enactment which was within the contemplation of the parties when they entered into the contracts.

The terms of the government price redetermination clause in the contracts before us are much broader than the clause found in the contracts in the case of *Mesa Petroleum Co. v. Kansas Power & Light Co.*, 229 Kan. ——, —— P.2d —— 1981). The escalator clause here refers to "any federal or Kansas regulatory *or governmental authority*". In *Mesa*, under the more limited escalator clause there contained, we found: "It is reasonable to assume that parties intended if Congress increased the maximum prices for which gas might be sold that this would fulfill the reference in [the government price escalator clause present in the Mesa contract] to action by any successor governmental authority." The intention of the parties is clearly expressed in the ERG-KPL contracts, which contain an "intent clause" not found

in the Mesa-KPL contracts; that clause clearly states that the purpose and intention of the parties is to increase the price of gas for the purpose of compensating ERG not only for anticipated increases in operating costs, but also for anticipated increases in the value of its natural gas.

The reasoning of the Federal Energy Regulatory Commission in its March 4, 1980, opinion in *Independent Oil and Gas Association of West Virginia*, Opinion No. 77, Util. L.Rep. (CCH) ¶ 12,274, is useful here. The Commission reaffirmed its holding in Order No. 23, referred to above, which withdrew the prohibition of the operation of indefinite price escalator clauses, sometimes also referred to as area rate clauses. The Commission said:

> "The fundamental concept underlying Order 23 is that, in determining whether a particular clause authorizes collection of NGPA rates, the Commission will endeavor to ascertain and give effect to the intent of the parties to the contract. . . . [I]ntent is the controlling factor with respect to this issue.
>
> "Our conclusion that the Commission is not limited to the 'four corners' of a contract in determining intent was arrived at after thorough consideration of the record developed in the rule making proceedings culminating in that order. . . . In view of the record developed in the rulemaking proceedings and in light of the accumulated experience of the Commission in dealing with area rate clauses in a variety of settings, there is ample reason to believe that the intent of the parties to permit prices to escalate to the highest rates allowed by law—including statutory rates—may not, in many cases, have been fully reflected in the terms they chose. Since the words they used were a product of the then prevailing regulatory scheme under the Natural Gas Act, we must attempt to ascertain, to the extent possible, what the parties intended to accomplish in the context of that regulatory

environment and to give effect to that intent in light of the changed circumstances brought about by enactment of the NGPA. . . .

"[W]e do not believe their intent should be thwarted merely because they failed to foresee that the Congress would assume the ratemaking function previously delegated to the Commission. . . ." pp. 14, 444-45.

As applied to the facts before us, the fundamental holding of Opinion 77 is that the Commission will not conclude that the transfer of the ratemaking function from the Commission to Congress—most likely unforeseen by the parties at the time the contract was drafted—operates to defeat the intent of the parties simply because they expressed that intent in the terms of the then prevalent ratemaking system. For similar reasoning applied under the old ratemaking procedures, see *Amoco Production Co. v. Kansas Power & Light Co.*, 505 F. Supp. 628 (D. Kan. 1980).

The ERG-KPL contracts were executed in 1975, when rates were prescribed by the Commission. The contracts, however, refer not only to regulatory bodies but to any "governmental authority having jurisdiction," and certainly the Congress is such a body. Viewing the instruments from their four corners, we conclude that the instruments are not ambiguous, and that the parties *intended* that the government price escalation clauses be triggered by enactments such as the NGPA.

Whether the contract price escalated from its November 9, level to the Section 102 level, however, is dependent upon the escalation clause in the contracts. In *Pennzoil Co. v. Federal Energy Regulatory Comm'n*, 645 F.2d 360 (5th Cir. 1981), discussing Section 105 of the NGPA the court says:

"If . . . the price on November 9th was less than section 102, under section 105 (b) (1) the maximum

> lawful price is the current price provided for under the terms of the contract as long as it does not exceed the section 102 price. . . . [In such a] case, the intrastate contract price may escalate from its November 9th level to the section 102 level, *provided that the contract has a sufficient escalation, mechanism.*" (Emphasis supplied.) pp. 374-75.

The final sentence of Section 6.7 of the ERG-KPL contracts provides that "[i]n that event [that a governmental authority fixes a higher price] the increased price shall be effective as of the date of action of the governmental or regulatory authority establishing the regulated price [November 9, 1978], or its effective date [December 1, 1978], *whichever is later. . . .*" (Emphasis supplied.) The November 9th price, then, continued until December 1, 1978, under the clear terms of the contracts.

Section 105 (b) (1) of the NGPA fixes the maximum lawful price of intrastate gas as the lower of the Section 102 price or "the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date . . ." We hold that under the terms of the government price escalator clause in these contracts, and under the applicable section of the NGPA, the November 9th gas price (which was lower than the Section 102 price) did not escalate. The rationale expressed in the *Mesa Petroleum Company* case is fully applicable here. The NGPA did not trigger a price increase because the contracts herein did not contain a sufficient escalation mechanism.

Appellant also contends that the district court erred in granting summary judgment as there were genuine issues of material fact, necessitating an evidentiary hearing. The fact issues, however, relate entirely to the intent of the parties, and since we have resolved that issue from the wording of the contracts themselves, no fact issue remains for determination.

The resolution of these issues, however, does not determine this lawsuit. We must also consider the price redetermination provision of the contracts, ERG's attempt to utilize those clauses, and the effect of the Price Protection Act thereon. The price redetermination clause provides in substance that upon request of the seller, the parties shall mutually redetermine the price by considering three contracts under which the highest prices are actually being paid for flowing gas. The "weighted average price" being paid under the contracts shall then become the redetermined price.

K.S.A. 1980 Supp. 55-1402 (*c*) provides:

> " 'Indefinite price escalator clause' means any provision of a gas purchase contract which provides for the establishment or adjustment of the price of natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum poducts."

K.S.A. 1980 Supp. 55-1404 provides in substance that the price paid or to be paid for natural gas in the State of Kansas shall not be taken into account in applying any indefinite price escalator clause contained in any gas purchase contract subject to this act. The act applies to natural gas purchase contracts entered into before April 20, 1977, providing for the sale of natural gas produced in this state and not committed to interstate commerce.

ERG contends that the Kansas act does not apply because, in addition to the prices paid for natural gas under other contracts, the price redetermination clause here requires the parties to make adjustments with reference to other factors, including but not limited to, the heating value of the gas, and costs of gathering, compression and processing rights. The primary thrust, however, of the price redetermination clause is to adjust and fix the price of the gas under these contracts based

upon the price paid for natural gas under other contracts. The price redetermination clause in these contracts appears to fit precisely within the definition of "indefinite price escalator clause" included in the statute and set forth above. ERG's argument is not persuasive, and we hold that the Kansas act prohibits now, and at the time requested prohibited, price redetermination under the applicable section of the contracts. This issue cannot, as ERG suggests, be determined in a manner which would avoid the constitutional issue.

ERG contends that the Price Protection Act violates the contract clause set forth in Article 1, Section 10, of the Constitution of the United States. The contract clause reads as follows:

> "No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . . ."

A memorandum opinion of the trial judge reflects his research and careful thought in this area. He says:

> "The constitutional bar against state legislation 'impairing the obligation of contracts' has not been given literal, unconditional application, making it destructive of the public interest by depriving the states of appropriate powers such as the right to impose price controls. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978).
>
> "The constitutionality of state legislation that alters contractual obligations of private parties is solely dependent upon whether or not such legislation is based upon reasonable conditions and is of character appropriate to the public purpose justifying its adoption. Legislation that is both reasonable and necessary to serve a public purpose does not offend the contract clause. To this end, the Supreme Court has employed a balancing approach to resolve contract clause challenges. The Court has flexibly re-

lied on several factors to determine the reasonableness of the legislative action. These include the severity of the legislation's impact on a private contract right, the scope and applicability of the legislation, and the importance of the public purpose that justifies its adoption.

"Here it is interesting to consider what the Court said in *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977). I quote headnote 13 [52 L.Ed. 2d at 95]:

> "'13. Although the states must possess broad power to adopt general regulatory measures without being concerned that private contracts will be impaired or even destroyed as a result, private contracts are not subject to unlimited modification under the states' police power for purposes of the contract clause of the U.S. Constitution (Art. I, § 10, cl. 1), prohibiting state impairment of contract obligations; legislation adjusting the rights and responsibilities of contracting parties must be upon reasonable condition and of a character appropriate to the public purpose justifying its adoption, *but, as is customary in reviewing economic and social regulation, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure.*' [Emphasis added.]

"KPL contends that the reasonableness of the Price Protection Act is quite clear in light of its important public purpose and the minimal contractual interest that it imposes. I agree, and here it is appropriate to look at what the Legislative Report which accompanied H.B. 2680 states:

" 'Due to the changes in the Gas Pricing System brought about by NGPA, H.B. 2680 would have the effect of restricting somewhat abrupt and unanticipated increases in the price of old gas dedicated to intrastate commerce under certain gas purchase contracts which contain indefinite price escalator clauses.

'The NGPA of 1978 marked a radical reversal of the federal policy toward the pricing of natural gas. This law is directed toward increasing the price of gas, with the ultimate goal of deregulation of gas pricing. For many years the federal policy was directed toward pricing gas on a cost of service basis in interstate commerce. The new policy is to establish ceiling prices which will rise monthly to the point of final deregulation of many categories of natural gas production on December 31, 1984.

'Proponents believe that as a result of this legislation, many producers of natural gas, especially those whose contracts contain indefinite price escalator clauses, will reap unanticipated, windfall financial benefits. These benefits bear no real relationship to the costs of production of new gas, and are not even remotely related to old gas production costs. They accrue solely because of the reversal of federal policy.

'The proponents stated that the burden of the increased costs will be passed by utility companies directly to the consumer. *The producers will benefit beyond any expectations that they might have had only a few years ago* and the consumers, already buffeted by rapidly increasing inflation, including spiraling utility costs, will pay. Natural gas prices will continue to increase in the foreseeable future.

'The Congress recognized this scenario and, as a result, specifically reserved to the states an area of price control applicable to intrastate gas sales, according to proponents.

'The proponents contended that H.B. 2680 represents an effort by the State of Kansas to minimize the impact on consumers of natural gas price increases of some intrastate gas from the present time through 1984. For a period of nearly six years, this bill would provide a modicum of restraint on some utility price increases.

'As a result of its hearings and deliberations, the majority of the Committee is strongly convinced that the single issue of the benefits to be derived by the affected Kansas consumers of natural gas clearly outweighs any adverse effects the gas producers or royalty owners said the bill might have. *Except where long-term, fixed price contracts are involved, the producers and royalty owners are benefiting significantly under the new NGPA. The bill merely prevents the producers from receiving the full amount of unanticipated gains that would be experienced.* Special Comm. on Energy and Natural Resources, *Report on H.B. 2680*, Exhibit A to Suggestions in Support of KPL's Cross Motion for Summary Judgment (Emphasis supplied).'

"The legitimate public purpose of the Price Protection Act cannot be questioned. See *Home Bldg. & L. Assn. v. Blaisdell*, 290 U.S. 398 (1934), at 444-45. In a time already facing serious problems of inflation, Kansas has a bona fide interest in addressing, and hopefully controlling, the serious economic dislocations that a sudden introduction of significantly higher energy costs would produce. The federal

government acknowledged the legitimacy of this public purpose by expressly reserving to the states the option to so act.

"Under the standards of *Allied Structural Steel*, and prior case law, the Price Protection Act is a reasonable path chosen to achieve this important public purpose. The relief is appropriately tailored to meet the conditions it addresses, and is neither overbroad nor overly harsh. See *Allied Structural Steel*, 438 U.S. at 244. It affects only old gas and gas for which a higher price has not yet been paid. The Price Protection Act merely prevents an automatic triggering of indefinite price escalator clauses.

"Additionally, the Price Protection Act is limited in time as well as scope. Its controls extend over a period of a few years to lessen the economic shock to citizens, businesses and institutions of this state, who are otherwise suddenly subject to significantly higher prices for natural gas that affects virtually every aspect of their lives. The measure chosen by Kansas does not seek forever to foreclose the introduction of those higher prices into the economy, nor to deny gas producers the ultimate increases in the purchase price of their resource. The legislation gradually spreads out over the NGPA's time period for gradual price deregulation, the ultimate, and perhaps inevitable, impact of those higher prices.

"The ramifications of the sudden introduction of these higher prices are clear. The Price Protection Act merely regulates these evils by graduating the introduction of higher natural gas prices into the Kansas economy. Some price increases are presently allowed, especially those that encourage new exploration and production from higher cost or low yield sources. Negotiations for new contractual price provisions are permitted to guarantee a measure of

fairness. Automatic price escalations, however, triggered by indefinite escalator clauses and unrelated to cost of production or factors of supply and demand, are postponed. A more reasonable and specifically tailored approach to the problem could hardly be imagined.

"In reviewing economic and social legislation against Contract Clause challenges, courts should defer to the legislature's judgment of the necessity and reasonableness of a particular measure. *United States Trust Co. v. New Jersey*, 431 U.S. at 23; *East New York Bank v. Hahn*, 326 U.S. 230 (1945). Even without that presumption of reasonableness and necessity, the Price Protection Act manifestly represents 'legislation adjusting the rights and responsibilities of contracting parties . . . upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption.' *Allied Structural Steel*, 438 U.S. at 244, quoting *United States Trust Co.*, 431 U.S. at 22; *Home Bldg. & L. Assn.*, 290 U.S. at 445-47.

"Both the nature of the regulation provided by H.B. 2680, and the commodity regulated, are high on the list of priorities of governmental restrictions and regulations. I refer to price regulation and energy. There is an abundance of precedent for price control legislation much more stringent than H.B. 2680, beginning with *Munn v. Illinois*, 94 U.S. 113 (1876), and continuing through the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), upholding an absolute prohibition on the operation of indefinite price escalator clauses. There is a very close connection with the manner the courts handle the contract clause of the U.S. Constitution and with the way they treat the due process clause of the Fourteenth Amendment. The Supreme Court has ex-

pressly stated that the states' power reasonably to regulate natural gas prices cannot seriously be questioned under the due process clause. As to the commodity being regulated, we would all have to be blind, deaf and dumb not to be aware that long before H.B. 2680 was enacted there was a national campaign to control all types of energy, including natural gas, which campaign or movement is still very much alive and can almost be classified as a crusade."

We agree with the district judge, and adopt the quoted portion of his memorandum opinion.

The NGPA constituted an entirely new and drastically different approach to the pricing of natural gas; it broke with the past, and substituted deregulation for close agency regulation under which the industry had operated for many years. Contract prices for natural gas on November 9, 1978, as disclosed by the several recent cases before us, varied from less than thirty cents per MCF to more than $1.90 per MCF. The Section 102 price for new gas and for natural gas produced on the outer continental shelf exceeded $2.00 per MCF. The anticipated sudden escalation of intrastate gas prices threatened both gas and electric utility rates. The legislature was cognizant of this emergency situation when it considered and enacted the Kansas Natural Gas Price Protection Act. That act protects the public generally from an immediate increase in rates; with allowed monthly increases, the rate increases will be phased in over a period of several years.

The legislation addresses an important public purpose. Under all of the attendant circumstances, we conclude that the legislation, and the tempering of price increases which it provides, are reasonable and appropriate.

ERG contends that the Kansas Act is retroactive to December 1, 1978, and, since it impairs the contract and disturbs the vested rights of ERG under the contract as of that date, it must fall. The statute obviously was intended to and does impair the rights of ERG under the contracts to invoke the price redetermination clause, and thus secure higher prices for its gas based upon prices paid for other gas. The date chosen for the retroactivity, December 1, 1978, is the date upon which the orders of FERC, regulating rates, ceased to be operative, and the provisions of the NGPA took effect.

The trial court concluded that the statute had no retroactive application. Since ERG did not attempt to invoke the price redetermination clause provisions of the contract until after the effective date of the statute, the application would appear to be primarily prospective only. However, ERG contends that it had the right under the contract to price redetermination, which rights vested upon the date the contract was executed, and that these rights were taken away when the Price Protection Act became effective, retroactive to December 1, 1978. The statute, as we have pointed out, was enacted under the police power of the state to regulate the intrastate price of natural gas. If the legislature could not make the statute retroactive to December 1, 1978, then it would have no effective way to control intrastate natural gas prices. Automatic escalator clauses, activated during that period, would nullify the powers of the state to protect its citizens in this important area. We conclude that the Kansas Act is an appropriate exercise of the police power of the state, that it was reasonable and fully justified under the circumstances, and that it is not unconstitutional upon the basis of its retroactivity.

Finally, ERG contends that the district court erred in failing to consider ERG's optional right to terminate the contracts. Its right to terminate depended upon (1)

whether the price increased, and (2) whether KPL violated the contract terms. Since, as we have held, the price did not escalate, KPL did not violate the contract terms and ERG had no right to terminate the contracts.

We have carefully considered the arguments and the authorities cited by counsel, but we find them unpersuasive and we will not prolong this opinion by a recital thereof.

The judgment is affirmed.

Opposition

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ALEXANDER

No. 81-711

In the Supreme Court of the United States

October Term, 1981

MESA PETROLEUM CO.,
Petitioner,

vs.

THE KANSAS POWER AND LIGHT COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

RESPONDENT KPL'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

I. Whether Mesa's Indefinite Price Escalator Clause In Its Intrastate Gas Supply Contracts With KPL Provided For A Price Increase On December 1, 1978, And Thus Authorized Mesa To Terminate Its Contracts Pursuant To The Terms Thereof On February 15, 1979, Based Upon Congressional Enactment Of NGPA Section 105.

II. Whether The Kansas Natural Gas Price Protection Act, Kan. Stat. Ann. Section 55-1401, Et Seq. (Supp. 1980), Prohibited The Price Increase Claimed By Mesa On December 1, 1978.

III. Whether The Federal Court Judgment Holding That The Price Protection Act Constitutionally Prohibited The Claimed Price Increase Under Mesa's Contracts On December 1, 1978, Is Res Judicata Against Mesa Here.

IV. Whether Interim Federal Regulations In Effect From December 1, 1978, Through February 15, 1979, Barred Mesa's Claims Of Price Increases, And The Terminations Based Thereon, By Prohibiting Operation Of Indefinite Price Escalator Clauses Based Upon Congressional Enactment Of The NGPA.

PARTIES

Respondent's true and correct name, as designated in the pleadings below, is The Kansas Power and Light Company ("KPL"). Respondent is a public corporation with no parent, subsidiary or affiliated corporations within the meaning of Supreme Court Rule 28.1. Respondent State Corporation Commission is an agency of the State of Kansas. Respondent KPL has no independent knowledge of whether Mesa Petroleum Co. has parent, subsidiary, or affiliated corporations within the meaning of Supreme Court Rule 28.1.

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No. 81-711

In the Supreme Court of the United States

October Term, 1981

MESA PETROLEUM CO.,
Petitioner,

vs.

THE KANSAS POWER AND LIGHT COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

RESPONDENT KPL'S BRIEF IN OPPOSITION

Respondent KPL respectfully requests that this Court deny the petition for a writ of certiorari that seeks review of the decisions of the Kansas Supreme Court in the above-captioned cases.

OPINIONS BELOW

The opinions of the Kansas Supreme Court are published in the official and West reporting systems, and may be found reported as *Mesa Petroleum Co. v. The Kansas Power and Light Company*, 229 Kan. 631, 629 P.2d 190, as clarified 230 Kan. 166, 630 P.2d 1129 (1981). The related decision relied upon by Mesa and attached to the petition is reported as *Energy Reserves Group, Inc. v. The Kansas Power and Light Company*, 230 Kan. 176, 630 P.2d 1142 (1981).

STATUTES AND REGULATIONS INVOLVED

Additional statutes and regulations involved in this appeal include Section 4 of the Kansas Natural Gas Price Protection Act, Kan. Stat. Ann. Section 55-1404 (Supp. 1980), which provides in pertinent part:

> On or after December 1, 1978, the price allowed to be paid pursuant to federal legislation or any regulation by an agency implementing such legislation, or the price paid or to be paid for any sale of natural gas in the State of Kansas, shall not be taken into account in applying any indefinite price escalator clause contained in any gas purchase contract subject to this Act, to the extent that such contract provides for the sale in the State of Kansas, of gas produced within this state which was not committed or dedicated to interstate commerce on November 8, 1978.

Interim regulations of the Federal Energy Regulatory Commission ("FERC") in effect on December 1, 1978, through February 15, 1979, when Mesa purported to terminate its contracts herein, provided as follows:

> The establishment of maximum lawful prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate contracts. 43 Fed.Reg. 56448, 56463.

This regulation remained in effect until March 13, 1979, after the dates on which Mesa claimed price increases and purported to terminate its contracts with KPL. 44 Fed. Reg. 16895 (March 20, 1979).

STATEMENT OF THE CASE

Petitioner Mesa Petroleum Co. ("Mesa") brought these three separate actions in three District Courts in Kansas for declaratory judgments that on February 15, 1979, Mesa terminated its gas supply contracts with respondent The Kansas Power and Light Company ("KPL").

Mesa claimed below that its contracts[1] provided for a price increase on December 1, 1978, to the maximum price ceiling newly established under the Natural Gas Policy Act of 1978, 15 U.S.C. Section 3301, et seq. (Supp. 1980) ("NGPA"). Mesa claimed that it terminated its contracts pursuant to the contract terms on February 15, 1979, because of KPL's refusal to elect to pay within 75 days the higher prices allegedly due on December 1, 1978. The price escalations demanded by Mesa, however, were not authorized by its contracts, were and still are unlawful under the Kansas Natural Gas Price Protection Act, Kan. Stat. Ann., Section 55-1401, et seq. (Supp. 1980) ("Price Protection Act" or "the Act"), and were in any event then prohibited by interim federal regulations.

Mesa bases its claim for termination upon the "Government Regulation" indefinite price escalator clause in its gas supply contracts. That clause provided that if a "successor governmental authority" to the FPC prescribed a price for natural gas higher than the contract price, then

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1. The language of all three contracts is virtually identical for purposes of these proceedings. The decision below disposed of Mesa's initial action in Grant County, Kansas. *Mesa Petroleum Co. v. The Kansas Power and Light Company*, No. 80-52646. The other two cases were consolidated in one judicial district and constituted a separate appeal to the Kansas Supreme Court. *Mesa Petroleum Co. v. The Kansas Power and Light Company*, No. 81-52885. The cases were argued the same day. The Court disposed of the second appeal by order referring to the opinion in the initial case.

the contract price would be increased to equal "such regulated price." Mesa claimed that under the meaning of its contracts, Congressional enactment of the NGPA constituted the action of a successor governmental authority that prescribed applicable natural gas prices sufficient to trigger contractual price escalations. A brief background to the NGPA is helpful.

Enactment of the NGPA in late 1978 represented the introduction of a new federal policy of gradual gas price deregulation. The NGPA provided for complete deregulation of many natural gas prices on January 1, 1985, and provided during the interim transition period an organized system for the gradual introduction of the higher prices ultimately expected with deregulation.[2]

Effective December 1, 1978, the NGPA abandoned the prior practice of administrative prescription of natural gas rates based upon cost of production and a reasonable rate of return. 15 U.S.C. Section 3431 (Supp. 1980). These rates were previously prescribed by the Federal Power Commission ("FPC"), and later by its successor agency, the Federal Energy Regulatory Commission ("FERC"). Also effective December 1, 1978, the NGPA established interim price ceilings that escalated on a monthly basis during the six-year movement toward gas price deregulation under that Act. 15 U.S.C. Section 3311, et seq. (Supp. 1980). The NGPA removes most of these interim ceilings on gas prices effective January 1, 1985, when prices are totally deregulated for many categories of natural gas. 15 U.S.C. Section 3331 (Supp. 1980).

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2. 15 U.S.C. Section 3331; See *Pennzoil Co. v. Federal Energy Regulatory Comm'n.*, 645 F.2d 360 (5th Cir. 1981) ("Pennzoil"); *Oklahoma v. Federal Energy Regulatory Comm'n.*, 494 F.Supp. 636 (W.D. Okla. 1980), aff'd ..... F.2d ..... (10th Cir. 1981).

The NGPA establishes different maximum price ceilings for different categories of gas. See 15 U.S.C. Section 3312, et seq. Each ceiling escalates monthly for inflation, 15 U.S.C. Section 3311, and certain categories have an additional growth factor for greater escalation. See, e.g., 15 U.S.C. Section 3312(b)(2)(B). If gas qualifies for more than one category, it is eligible for the highest category for which it qualifies. 15 U.S.C. Section 3311(b)(5). However, the NGPA does not grant any federal right to higher prices under intrastate contracts. Intrastate prices may escalate "provided that the contract has a sufficient escalation mechanism."[3] "In no case may a seller receive a higher price than his contract permits."[4] Several categories are relevant here.

The price ceiling established under the NGPA for new gas is the Section 102 price. 15 U.S.C. Section 3312. Section 108 establishes the ceiling on stripper well gas. 15 U.S.C. Section 3318. Ceiling prices for these gas categories are lifted in 1985. 15 U.S.C. Section 3331.

For old interstate gas flowing in 1978, the NGPA establishes various price ceilings in Section 104. Section 109 controls other categories of old gas and establishes a ceiling equal to the highest ceiling in Section 104 for old interstate gas under contract. 15 U.S.C. Sections 3314, 3319; 46 Fed.Reg. 38910 (July 30, 1981). These gas categories are not deregulated under the NGPA and the price ceilings therefor continue indefinitely. 15 U.S.C. Section 3331.[5]

NGPA Section 105 establishes a ceiling for that part of Mesa's production about which this lawsuit was brought—

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3. *Pennzoil*, supra, 645 F.2d at 375, quoting H.R. Rep. No. 1752, 95th Cong., 2d Sess. 82 (1978); 124 Cong. Rec. H. 13117 (Daily Ed. October 14, 1978) (statement of Rep. Dingell).

4. Joint Explanatory Statement of the Comm. on Conf., S. Rep. No. 1126, 95th Cong., 2d Sess. 74 (1978).

5. See *Pennzoil*, supra, 645 F.2d at 367.

intrastate gas under contract on November 8, 1978. Section 105 establishes as a ceiling the *lower* of the Section 102 new gas price and the "price under the terms of the existing contract . . . as such contract was in effect on [November 9, 1978]." 15 U.S.C. Section 3315(b)(1). Mesa claims that its contract price escalated to the Section 102 price, as the highest price within Section 105, based upon the operation of its price escalator clause. The clause allegedly adopted the higher price "prescribed" in this section based upon Congressional enactment of Section 105.

The Section 105 intrastate gas price ceiling, however, is qualified by NGPA Section 602, which expressly provides that states may impose more stringent price controls on intrastate gas or on "the operation of any indefinite price escalator clause" in contracts for the sale of such gas. 15 U.S.C. Section 3432(a).[6]

In its first session after enactment of the NGPA, the Kansas Legislature enacted on May 29, 1979, the Kansas Natural Gas Price Protection Act, Kan. Stat. Ann. Section 55-1401 et seq. (Supp. 1980) ("Price Protection Act" or "the Act"). The Act implemented the policy of state price controls embraced within the NGPA system for regulation of intrastate prices.

The Price Protection Act allowed intrastate new gas prices in Kansas to escalate to the Section 102 price for new gas in the interstate market, and the intrastate stripper gas price to escalate to the Section 108 price, the price for that same gas in the interstate market under the NGPA. Kan. Stat. Ann. Section 55-1406. The Act limited price increases on old intrastate gas in Kansas to the NGPA Section 109 price, which equals the highest NGPA ceil-

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6. See also Joint Explanatory Statement of the Comm. on Conf., H. Conf. Rep. No. 1752, 95th Cong., 2d Sess. at 125, *reprinted in* [1978] U. S. Code Cong. & Admin. News at 9041.

ing established for old gas in the interstate market under Section 104. Kan. Stat. Ann. Section 55-1405.

The Price Protection Act expressly made its controls effective retroactive to December 1, 1978, when the NGPA intrastate price ceiling first became effective. The Act thus foreclosed the price increase here claimed by Mesa on that date. Mesa does not challenge here the applicability of that statute to bar its present claim, nor the federal court ruling that held constitutional the application of that statute to the same Mesa contracts before this Court.

In November 1978, Mesa informed KPL by letter that on December 1, 1978, the price on old gas delivered pursuant to its contracts would escalate to $2.078 per million BTU's the NGPA Section 102 new gas price. Mesa claimed that its contract clause triggered an escalation on December 1 based upon the enactment of the NGPA price ceilings.

Pursuant to the terms of all three contracts, Mesa declared a termination of the contracts on February 15, 1979, because of KPL's refusal to pay the claimed higher price. Mesa filed three separate actions in Clark, Meade, and Grant Counties in Kansas for declaratory judgments of whether it could and did in fact terminate its contracts with KPL on February 15, 1979.

On June 10, 1981, as later clarified on July 17, 1981, the Supreme Court of Kansas unanimously affirmed uniform trial court rulings that the contracts did not provide for a price increase based upon mere enactment of the NGPA Section 105 price ceiling. The Court ruled:

> [Prices were permitted] by the NGPA to escalate under the terms of the various contracts not to exceed certain ceiling prices provided for in the [NGPA]. Provisions in these contracts for definite and indefinite escalations of prices and for redetermination of prices

> by later agreement are not nullified by the Act. However, these are limited by the terms and conditions agreed to by the parties in the contracts. In our present case, *the contract as drawn by the parties did not provide for the payment of the highest price allowed by law* and this Court will not rewrite the contract to authorize that result.

Mesa Petroleum Co. v. KPL, 230 Kan. 166, 630 P.2d 1129 (1981) (clarifying opinion, emphasis added).

Because the Court's ruling was dispositive of the appeal, the Court declared that it did not address the remaining issues briefed by the parties. *Mesa Petroleum Co. v. KPL*, 229 Kan. 631, 629 P.2d 190, 195 (1981). Because these issues also barred Mesa's claim, they are briefly presented here.

Mesa here petitions for a writ of certiorari and claims that the state court erred in declaring its rights under the contracts because the Court allegedly misconstrued the NGPA.

REASONS WHY THE WRIT SHOULD BE DENIED

I. The Kansas Decision Resolves the State Law Question That Mesa's Contracts Did Not Provide for a Price Increase on December 1, 1978, and the Decision Does Not Conflict With the NGPA, With Decisions of the Federal Courts or FERC, or With Congressional Intent.

Mesa asserts herein a right solely arising under common law contract principles. Mesa claimed below that its contracts had a sufficient mechanism to escalate its contract prices to NGPA ceiling prices. Mesa further claimed a contract right to terminate the contracts based upon

KPL's failure to pay the alleged higher prices. The Court below, however, determined that the contracts did *not* have a sufficient mechanism to escalate the contract prices to NGPA ceiling prices as a result of mere enactment of the NGPA. Mesa misapprehends the Kansas Court's decision as holding the NGPA to bar its contract claims.[7]

Mesa's Question Presented erroneously implies that Mesa had a right to higher prices as a result of NGPA enactment, but that the Court misconstrued the NGPA to freeze its contract prices. Mesa, however, does not assert any federal right. The NGPA did not grant any seller any *right* to increased gas prices, but established maximum price *ceilings* available only on the authority of existing contracts, provided the contract had a sufficient escalation mechanism to authorize collection of the higher price.

Mesa's rights in dispute here arose, if at all, from contracts with KPL. The decision below addressed Mesa's contractual price escalator clause and found it insufficient to increase contract prices to NGPA ceiling prices. This was a state law issue jurisdictionally insufficient for review in this Court. Indeed, Mesa previously agreed with this proposition.

When Mesa first filed these actions for declaratory relief, KPL petitioned the Federal Energy Regulatory Commission for a declaratory order of whether Mesa's contract would authorize a price increase in conjunction

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7. This Court has ruled before that actions for declaration of rights under contracts do not raise federal questions within 28 U.S.C. Section 1331(a), even when federal law authorizes or controls those contract rights. See *Pan American Petroleum Corp. v. Superior Court*, 366 U.S. 656 (1961); *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667 (1950). Mesa seeks jurisdiction for certiorari by contending that the Kansas Court decided the case against Mesa by relying on a federal question defense reviewable under 28 U.S.C. Section 1257(3).

with enactment of the NGPA. Mesa moved to dismiss that petition and argued that the issue presented was solely one of state law controlling the interpretation of a state contract.

FERC agreed with Mesa, and dismissed KPL's petition as raising matters solely within state contract law. See *The Kansas Power and Light Company v. Mesa Petroleum Co.*, No. GP79-4 (FERC August 10, 1979). FERC ruled that whether intrastate contracts provided for price increases in conjunction with NGPA Section 105(b) was an issue of state law that the NGPA left to state courts to resolve. Federal courts commonly cite that decision for the proposition that state law controls whether an intrastate contract may authorize price increases to NGPA price ceilings.[8] Mesa first asserted that this case presented a federal question after the Court below ruled that its contract did not automatically provide a price increase to NGPA ceiling prices in conjunction with NGPA enactment.

Mesa's entire argument rests on the mistaken assertion that the state court's decision erroneously interpreted NGPA Section 105(b). Mesa and Amici argue that the decision below forecloses any price increase under *any* escalator clause subject to NGPA Section 105(b)(1). Neither the language nor the effect of the state court's decision dictates such a result.

Mesa's entire petition here addresses the original opinion of the Court below, and not the clarifying opinion issued by the Court on Mesa's motion for rehearing. The Court therein addressed the contentions that Mesa advances here, and the Court rejected Mesa's contentions as a misinterpretation of its earlier holding.

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8. See *Pennzoil*, supra, 645 F.2d at 390; FERC Order No. 23, Docket No. RM79-22, 44 Fed.Reg. 16895 (March 20, 1979).

Contrary to Mesa's argument, the Kansas Court noted that the NGPA neither prohibited nor required the operation of indefinite price escalator clauses. The Court noted, however, that the NGPA did not grant Mesa any right to any higher price. *Mesa v. KPL, supra*, 630 P.2d at 1130. The Court held that Mesa's specific indefinite price escalator clause was not a sufficient mechanism by which to escalate prices to NGPA price ceilings:

> In our present case, the contract as drawn by the parties did not provide for payment of the highest price allowed by law and this Court will not rewrite the contract to authorize that result. *Mesa v. KPL*, supra, 630 P.2d at 1131.

Mesa disingenuously contends that the state court ruled that the NGPA prohibits any price escalation in intrastate gas contracts. The Court expressly noted in its opinion on rehearing that other clauses, including fixed price escalator clauses, price redetermination clauses, and indefinite price escalator clauses triggered by other events, *would* function in Kansas. *Id.*, 630 P.2d at 1131. Indeed, the Kansas Supreme Court ruled in a companion case that a price redetermination clause in an intrastate gas contract would *indeed* trigger higher prices in Kansas, subject to restrictions of state law. See *Energy Reserves Group, Inc. v. KPL*, 230 Kan. 176, 630 P.2d 1142 (1981). The Court proceeded to determine whether state law would prohibit or limit the operation of that clause. *Id.*, at 1150.[9]

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9. Mesa's claim that the Kansas Court ruling freezes all price increases under gas contracts in Kansas is a less than candid representation of both the Kansas opinion and Mesa's understanding of it in actual practice. Mesa's contracts contain a fixed price escalator clause that provides for definite price escalations on designated dates. Mesa is presently receiving these price escalations under its contracts.

(Continued on following page)

The decision below resolves a dispute regarding rights under private contracts. The decision turns on the intent of the parties and on the operation and interpretation of contracts between them. As such, the decision rests upon a state law ground. Respondent respectfully submits that this issue is jurisdictionally insufficient to support Mesa's petition for a writ of certiorari.

II. State Statutory Law Bars Mesa's Claim.

An additional state law ground, which was fully briefed in the Court below, prohibits the price increase claimed by Mesa on December 1, 1978. Mesa's claimed termination is predicated on a price increase on December 1 that the Price Protection Act specifically forbids. Kan. Stat. Ann. Section 55-1401, et seq. (Supp. 1980).

Section 4 of that Act specifically restricts the operation of indefinite price escalator clauses in intrastate contracts, like that involved here, effective December 1, 1978. Section 4 of the Act prohibits Mesa from taking into account the enactment of NGPA price ceilings in the operation of its escalator clause. Kan. Stat. Ann. Section 55-1404 (Supp. 1980). Section 5 of the Act thereafter states that the clause may operate for old natural gas under contract, like that of Mesa, up to the NGPA Section 109 price that equals the highest Section 104 ceiling for old

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Footnote continued—

Mesa likewise has price redetermination clauses in the same contracts, and Mesa demanded price increases for its gas under these provisions of its contracts. In recognition that those clauses would authorize price increases as limited by state law, the parties agreed upon new price terms that specifically established the price increases under these contracts. Mesa is presently receiving that increased price for its natural gas. No party has contended before that the state decision below prohibits price redetermination under intrastate gas contracts to increase contract prices above November 9, 1978, levels.

interstate gas under the NGPA. Kan. Stat. Ann. Section 55-1405 (Supp. 1980).[10]

On December 1, 1978, Mesa's contract price already exceeded the NGPA Section 109 price. The Act thus prohibited the escalation claimed by Mesa to the NGPA Section 102 new gas price for its old intrastate gas on that date.[11] Application of the statute to Mesa's contracts bars Mesa's claim of contract termination based on that alleged price increase.

III. KIOGA's Unsuccessful Litigation of Mesa's Interest in Federal Court Is Res Judicata Against Mesa's Claim Here.

In early 1979, the Kansas Independent Oil and Gas Association ("KIOGA") sought leave to intervene in a representative capacity in a declaratory judgment action brought by independent gas producers in federal court to challenge the Price Protection Act on constitutional grounds. *Edmiston v. KPL*, No. 79-1335 (D.Kan. 1980), appeal pending, No. 81-1197 (10th Cir., docketed Feb. 23, 1981). KIOGA, a petitioner for amicus status here, claimed that its members generally, and Mesa specifically, had con-

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10. Other sections of the Act permit the operation of indefinite price escalator clauses in intrastate contracts in Kansas to operate to the NGPA Section 102 new gas price for any new gas delivered under the intrastate contract, and to the NGPA Section 108 stripper gas price for any stripper gas delivered pursuant to that intrastate contract. Kan. Stat. Ann. Section 55-1406 (Supp. 1980). The Act thus allows indefinite price escalator clauses for intrastate gas in Kansas to operate to the same NGPA price ceilings established in the interstate market for those same gas categories.

11. The Kansas Supreme Court has ruled in a separate action that the Act has retroactive effect to December 1, 1978, when the NGPA price ceilings under Section 105 became effective, subject to state restriction under Section 602. *Energy Reserves Group Inc. v. KPL*, supra, 230 Kan. 176, 630 P.2d 1142 (1981). One lower federal court has upheld the retroactive application of the Price Protection Act to Mesa's contracts. See Point III, infra.

tracts with indefinite price escalator clauses that were adversely affected by the Price Protection Act. KIOGA alleged this injury to its members to obtain standing to challenge the statute on behalf of its members in federal court.

To establish its interest of record, KIOGA submitted for the Court's consideration the same contracts of Mesa, a KIOGA member, that Mesa litigated in this action. KIOGA claimed that the Price Protection Act adversely and unconstitutionally affected these Mesa contracts, and that KIOGA therefore challenged the statute to protect Mesa's interest.

On November 24, 1980, as later amended on January 13, 1981, the federal court entered final judgment in favor of KPL and against KIOGA. The Court declared the Price Protection Act constitutional and upheld its retroactive application to December 1, 1978, the effective date of the new NGPA price ceilings for intrastate gas. The Court held that the statute constitutionally applied to bar the price increases claimed by Mesa, as represented by KIOGA, on December 1, 1978. A copy of the record in that federal action was included in the record before the Kansas Court below.

The federal judgment became final during the pendency of Mesa's appeal to the Kansas Supreme Court in this litigation. That judgment was then and is now res judicata against Mesa's claims. It expressly foreclosed the claimed price increase upon which Mesa's claims of termination in this litigation necessarily depend.

An issue that is actually litigated and necessarily determined is conclusive in other suits involving a party and its privies in the first concluded litigation. *Parklane Hosiery Co. v. Shore,* 439 U.S. 322 (1979). The collateral estoppel effect of a prior judgment applies whenever the

same interest of the same person is litigated in separate suits, even if that interest is represented by a different party with standing and authority to do so. *Chicago R.I. & P. Ry. v. Schendel,* 270 U.S. 611 (1926); 1B *Moore's Federal Practice,* Para. 0.411[1] at 1255, Para. 0.411[3] at 1435, Para. 0.411[12] at 1665, et seq. (2d ed. 1980).

The federal court judgment thus binds Mesa here, whose interest was adequately represented by a party to the original suit. No question exists that KIOGA intervened in the federal action to represent the interests of its members generally, and Mesa specifically, on the contracts here before this Court. Indeed, KIOGA expressly so declared. KIOGA thus presented and litigated Mesa's interest in the constitutional application of the Price Protection Act to Mesa's contracts here before this Court. The federal judgment holds that the state statute constitutionally restricted the price increases claimed by Mesa. That judgment binds Mesa in this litigation.[12]

Nor does KIOGA's appeal from the federal judgment alter this result. The final federal judgment is entitled to res judicata effect during the pendency of its appeal. *Huron Holding Co. v. Lincoln Mine Operating Co.,* 312 U.S. 183 (1941); *Stoll v. Gottlieb,* 305 U.S. 165, 170-71 (1938); *Reed v. Allen,* 286 U.S. 191, 199 (1932); *Deposit Bank v. Frankfurt,* 191 U.S. 499 (1903); 1B *Moore's Federal Practice,* Paragraph 0.416[3] at 2252 n. 11 (2d ed. 1980).

It is not material that the state trial court had entered his decision below before the federal judgment issued. "It is the first final judgment rendered in one of

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12. See *Expert Electric, Inc. v. Levine,* 554 F.2d 1227, 1235-36 (2nd Cir. 1977) (contractors' suit precluded by prior judgment against voluntary association that claimed injury to member contractors); *United States v. ITT Rayonier, Inc.,* 627 F.2d 996, 1003 (9th Cir. 1980); *Griffin v. Burns,* 570 F.2d 1065, 1071 (1st Cir. 1978) (where interest of person sought to be bound was presented and adjudicated in the prior litigation, issue preclusive effect attaches).

the courts which becomes conclusive in the other as res judicata." *Chicago R.I. & P. Ry. v. Schendel*, 270 U.S. 611, 616-17 (1926). Res judicata may be asserted for the first time in an appellate court when a judgment with preclusive effect has elsewhere been rendered during the pendency of an appeal. *Hart Steel Co. v. Railroad Supply Co.*, 244 U.S. 294 (1917).

The final federal judgment preceded any final judgment in the state courts in this litigation.[13] Mesa's claim is barred by state law, unless and until that federal decision is reversed. *Reed v. Allen*, 286 U.S. 191, 199 (1932). Mesa cannot escape the effect of the federal judgment and continue to litigate its claims in two court systems.

IV. Interim Federal Regulations Barred Mesa's Demands on December 1, 1978.

Mesa predicated its alleged February 15 termination of these contracts upon the alleged escalation of gas prices thereunder to NGPA maximum price ceilings. Then extant federal regulations, however, prohibited contractual escalation to NGPA ceilings based upon Congressional establishment of NGPA price ceilings.

Mesa quotes in its petition the final FERC regulations issued in conjunction with the NGPA. These regulations, however, were not issued by FERC until *after* Mesa had already demanded a price increase and *after* Mesa had purported to terminate its contracts. The interim regulations

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13. The federal rule differs from that governing state judgments in Kansas. Res judicata effect does not arise on state judgments obtained in Kansas courts until all appeals are exhausted. See *Randall v. Pepsi-Cola Bottling Co.*, 212 Kan. 392, 510 P.2d 1190, 1194 (1973); *In re Estate of Mullin*, 201 Kan. 756, 443 P.2d 331, 337 (1968); Annot. 9 A.L.R.2d 984 (1950). Judgments are entitled to the res judicata effect granted them by the forum wherein they are rendered. See 1B *Moore's Federal Practice*, Para. 0.416[3] at 2256 (2d ed. 1980), and cases cited therein. Thus the Kansas trial court judgment did not bind the federal court and bar it from litigating Mesa's claim that application of the statute to its contracts would be unconstitutional.

in effect when Mesa demanded the price increase based on NGPA enactment forbad these claimed escalations.

The interim regulation that controlled escalation under these contracts during the relevant time period was explicit: "The establishment of maximum lawful prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate contracts." 18 C.F.R. Section 270.205 (December 1, 1978) (See historical comment); 43 Fed.Reg. 56448, 56463. On its face, this regulation barred any price increases otherwise available under Mesa's "government regulation" clause, which triggered higher prices solely on the basis of government action that prescribed those prices.

The parties fully briefed this issue below. Mesa argued that this regulation was withdrawn by FERC before the February 15 date on which Mesa could terminate its contracts pursuant to their terms. The notice of proposed rulemaking on which Mesa relied, which issued on February 13, 1979, made no reference whatever to simultaneous retraction of the interim regulations. The Code of Federal Regulations expressly noted that the interim regulations were first replaced with the issuance of FERC Order 23, issued on March 13, 1979, three and one-half months after Mesa here claims its contract prices escalated, and one month after Mesa allegedly terminated the contracts for KPL's refusal to pay that higher price.

Mesa also argued that Interim Regulation 270.205 did not prohibit payment of escalated prices because interim collection regulations authorized collection of NGPA prices during the pendency of any applications therefor. Those regulations, however, authorized interim collection only if the specific contract provided for the higher price. 18 C.F.R. 273.101 (1980). Mesa assumed the point that Mesa had to prove: Unless Mesa's contracts escalated to provide a higher price, Mesa could not collect any higher price pursuant to these regulations.

Mesa cannot dispute that Interim Regulation 270.205 barred the price increase Mesa claimed on December 1, 1978, upon which its right to terminate on February 15, 1979 depended. Mesa's claim lacked merit for all of the reasons stated herein and was properly rejected by the state court.

CONCLUSION

Mesa sought in this action a declaratory judgment that its gas supply contracts with KPL automatically authorized a price increase for its old intrastate gas to the maximum NGPA ceiling price for new gas. Mesa alleged entitlement to this price solely based on Congressional enactment of NGPA intrastate gas price ceilings, which the NGPA established subject to state restriction. Mesa's claim was deficient on numerous bases, and the Kansas Court properly disposed of Mesa's appeal.

For the reasons set forth herein, Respondent respectfully submits that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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Supplemental Brief

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No. 81-711

In the Supreme Court of the United States

October Term, 1981

MESA PETROLEUM CO.,
Petitioner,

vs.

THE KANSAS POWER AND LIGHT COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

SUPPLEMENTAL BRIEF OF RESPONDENT KPL

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SUPPLEMENTAL BRIEF OF KPL RESPONDING TO THE POSITION OF AMICI UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Respondent The Kansas Power and Light Company ("KPL") respectfully submits this Supplemental Brief to inform the Court of facts relevant to the position presented in the Amici Brief of the United States of America and the

Federal Energy Regulatory Commission ("Commission").[1] KPL submits these remarks to inform the Court that Amici's position is based on ex parte communications from Petitioner Mesa Petroleum Co. ("Mesa"). This position reflects an incomplete and inaccurate understanding of the facts of this case and the parties' performance under the contracts before the Court.

The Commission and the United States address in their Brief the same illusory Question Presented that Mesa has drafted in its Petition: Whether the Supreme Court of Kansas erred by allegedly ruling that NGPA Section 105(b)(1) prohibited all price escalations under intrastate contracts and thus "froze" intrastate contract prices to November 9, 1978 price levels.[2] The Commission asserted this position without knowledge that Mesa is presently receiving price increases under price escalation clauses in the same contracts. These prices exceed the November 9, 1978 price to which the Kansas decision allegedly limits Mesa's contract price. KPL respectfully submits that the Commission was unaware that Mesa cannot argue that the decision below erroneously interprets

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1. The Commission and the United States did not serve copies of their Amici Brief on any counsel for either Respondent at the time of filing, as required by Supreme Court Rules 36.5 and 28.3, nor did Amici inform or otherwise give notice to either Respondent that Amici intended to file, or indeed had filed, a brief in this action. The Certificate of Service filed with the Amici Brief reflects that service was made on three separate counsel for Petitioner Mesa Petroleum Co., but not on counsel for either Respondent, notwithstanding that Amici filed their brief after counsel had entered their appearance in this action and after Respondents' Briefs had been filed. Respondent KPL first learned of the Amici Brief on December 14, 1981, when a party in another action cited this brief in a pleading there served on KPL. KPL first obtained the Amici Brief on December 15, 1981, after a personal request to counsel. This Supplemental Brief was prepared immediately after receipt of that Brief.

2. 15 U.S.C. Section 3315(b)(1) (Supp. 1980). See generally Natural Gas Policy Act of 1978, 15 U.S.C. Section 3301, *et seq.* (Supp. 1980).

Federal law to freeze intrastate prices and bar price increases under the instant contracts.

When the Commission filed its Amici Brief herein, it was not aware that Mesa's contracts contain provisions for definite, fixed price increases on designated dates, and that Mesa is presently receiving those price increases *consistent with* the State decision below. Mesa has received and accepted those price increases without qualification on the dates specified in the contracts. Those payments are not subject to refund, nor are they contingent on the outcome of this litigation. Those price increases have escalated Mesa's contract price above the November 9, 1978 level to which Amici mistakenly refer as the limit under the Kansas decision.

The Commission was also unaware at the time it filed its Amici Brief that Mesa's contracts provided for indefinite price increases on specified dates pursuant to a price redetermination clause contained therein. The Commission was not aware that the parties understood that this clause would indeed function, as limited by state law. Pursuant to this understanding, the parties specifically agreed on separate price increases under Mesa's contracts, which Mesa now receives.[3] These increases are not subject to refund under the contract, nor are they paid and accepted subject to any contingency, including the outcome

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3. Mesa presently receives under these contracts virtually the maximum price allowed for its gas in Kansas by the Kansas Natural Gas Price Protection Act, Kan.Stat.Ann. Section 55-1401 *et seq.* (Supp. 1980). The Kansas Act allows price increases for Mesa's old gas up to the monthly escalating NGPA Section 109 price, which equals the highest ceiling price provided under NGPA Section 104 for old interstate gas flowing in 1978. Mesa receives that monthly escalating price. Any new or stripper-well gas delivered under Mesa's contracts is entitled to receive the NGPA Section 102 or 108 price, respectively, as allowed by the Kansas Act and as agreed by the parties.

of this litigation.[4] These price increases escalated Mesa's present contract price far above the November 9, 1978 price, which Mesa disingenuously represents as the contract price under the Kansas decision.

Amici were thus unaware that Mesa's Petition does not and cannot present the question of whether the Kansas decision misconstrues the NGPA to freeze all prices under intrastate contracts. Mesa's receipt of price increases under its contracts is markedly inconsistent with its position in this Court that it is aggrieved by a ruling below that federal law prohibits those price increases.

If, as Amici claim, the Kansas Court ruled that NGPA Section 105(b) barred price escalations, then Amici cannot explain how the Court could rule that other escalation clauses in contracts subject to the same NGPA section *could* provide these price increases based upon different contractual language. The Court below ruled that price increases were permissible under state and federal law pursuant to other clauses, including a redetermination clause like that in Mesa's contracts.[5] The approach of the Kansas Court clearly indicates that its decision only bars

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4. Mesa attempts to argue that KPL retreated from an earlier position in paying certain price increases under these contracts. Petitioner's Reply Memo at 2 n. 5. This is patently untrue. KPL and the State Corporation Commission have *always* agreed that the NGPA allows intrastate price increases, subject to NGPA ceilings and consistent with the provisions of individual contracts. KPL has *always* maintained that Mesa's price redetermination clause and fixed price escalator clause provide for price increases consistent with state law. KPL so argued to the Kansas Court below. The Court below so held. *Mesa Petroleum Co. v. The Kansas Power and Light Company*, 230 Kan. 166, 630 P.2d 1129, 1131 (1981) (clarifying opinion). These price increases above November 9, 1978 levels were paid and accepted based on that understanding.

5. See *Energy Reserves Group, Inc. v. The Kansas Power and Light Company*, 230 Kan. 176, 630 P.2d 1142, 1150 (1981); *Mesa Petroleum Co. v. KPL, supra*, 230 Kan. 166, 630 P.2d 1129, 1131 (clarifying opinion).

the price escalation under Mesa's contract clause based upon Mesa's specific contractual language.

The only question that Mesa can genuinely raise herein is whether *one particular clause* in its contracts provided a price increase on a designated date. This question is solely based upon the issue of whether certain national events fit within the meaning and intention of a particular contract. This is all that the Court below held. This is the sole question before this Court.

Mesa's contract clause provided for price increases when a certain government authority *"prescribed a higher price"* for gas in Kansas. Mesa claimed its price increase here when Congress enacted an intrastate price ceiling equal to the *lower* of the NGPA Section 102 price and the "price under the terms" of the contract.[6] Mesa claimed

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6. Mesa has implied here for the first time that Congressional enactment of Section 102, rather than Section 105(b), triggered the price increase under its contracts. Petitioner's Reply Memo at 5 n. 14. Mesa never made this claim below, and it cannot advance this claim here.

Mesa has repeatedly changed its claim of the triggering event under its contracts. Mesa initially claimed below that its contract clause triggered price increases based upon enactment of Section 105(b). When Mesa acknowledged that interim Federal regulations then prohibited price escalations based upon enactment of NGPA ceilings, Mesa based its claim of triggering on *payment* of NGPA prices by other purchasers.

When Mesa failed to establish that any other purchaser had paid a Section 102 price before Mesa purported to terminate, Mesa claimed that *sales* at NGPA prices triggered its price increase during the pendency of the interim Federal regulations. In its last brief before sumitting the matter to the trial court, Mesa expressly stated that its claim of triggering was *not* based on enactment of NGPA ceiling prices. The Kansas Court properly found, however, that Mesa's clause did not provide for increased prices based upon sales at higher prices by other producers.

In its motion for rehearing in the State Supreme Court, Mesa claimed for the first time that its contract clause triggered a price increase based upon Congressional enactment of the NGPA Section 108 ceiling for stripper well gas. Mesa's gas,

(Continued on following page)

that this governmental action "prescribed a higher price" within the meaning of its contracts sufficient to trigger a higher contract price.

Enactment of this NGPA Section allegedly "prescribed a higher price," however, only *because* the "price under the terms" of Mesa's contracts allegedly equaled the higher Section 102 price. The price so equaled the 102 price only if the clause had already escalated. Escalation under the contracts was thus only possible *based upon* that same escalation that Mesa sought. The circularity of the claim within the terms of Mesa's contracts was obvious. Denial of the claimed price increase under this clause was proper.

Amici incorrectly state that the Court below construed the contract to provide a price escalation that the NGPA then forbade. Amici ignore the clarifying opinion below, which provides expressly to the contrary. That opinion addresses the conditions on which "the contract provides for escalation," and holds that "the contract *as drawn by the parties* did *not* provide for payment of the highest price allowed by law." *Mesa Petroleum Co. v. KPL, supra,* 630 P.2d at 1130-31 (emphasis added). That opinion is conclusive on this question of state law.

The ultimate issue in this case plainly cannot be resolved by this Court. Mesa and Amici here seek an admitted interpretation of the NGPA with which both Respondents agree. Amici agree, however, that the NGPA does not provide Mesa any federal right to higher intrastate

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Footnote continued—

however, did not qualify as stripper gas under the NGPA. NGPA Section 101(b)(9) provides that the relevant NGPA ceiling price—here Section 105—supercedes and nullifies any contract clause that provides for prices above the ceiling for that gas. The Court properly did not consider this belated and deficient claim.

KPL respectfully submits that Mesa's new claim is likewise not properly before this Court for consideration.

prices. Whether Mesa may receive a price increase under the terms of its contracts is admittedly a question of state law subject to resolution by the state court.[7]

If this case is remanded, the Court below may merely reaffirm its prior ruling that Mesa's contract clause does not provide for price escalations. Jurisdiction does not exist for review of that decision here. Indeed, the Kansas legislature has already enacted a law, as authorized by the NGPA, that prohibits the price escalation sought by Mesa. The constitutionality of the application of that statute to bar those price escalations has already been determined in a related case before the State Supreme Court, and in a companion case in Federal District Court brought on Mesa's behalf by an association to which it belongs.[8]

KPL initially requested that the Commission determine whether the contracts between these parties provided for the challenged price increase. Mesa there moved, however, and the Commission agreed, to dismiss the action as presenting a matter of state law for the state courts. KPL has attached as an Appendix hereto Mesa's Motion and Brief and the Commission Order disposing of this same case, which Amici conspicuously fail to cite.

Amici admit that whether these contracts provide for an escalation based upon NGPA enactment is not their con-

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7. Both the Commission in its prior Order and the Fifth Circuit Court of Appeals state that the identical language in two separate contracts could produce different price escalations, or no price escalations whatsoever, based upon the application of differing state law. See *Pennzoil Co. v. FERC*, 645 F.2d 360, 386 (5th Cir. 1981); *The Kansas Power and Light Company v. Mesa Petroleum Co.*, Docket No. GP79-4, at 4, Appendix at A-12.

8. See *Energy Reserves Group, Inc. v. The Kansas Power and Light Company*, 230 Kan. 176, 630 P.2d 1142 (1981); *Edmiston v. The Kansas Power and Light Company*, No. 79-1335 (D. Kan. 1980), appeal pending, No. 81-1197 (10th Cir. docketed February 23, 1981).

cern. Amici and Mesa, however, merely request that this Court reverse the decision below, issue a statement that the NGPA does not prohibit any intrastate price escalations provided by contract, and then remand to the state court for the same deliberation which the Court already undertook on rehearing: a determination of whether the contracts provide for a price increase in light of the same NGPA interpretation that was available to the state court in *Pennzoil Co. v. Federal Energy Regulatory Commission*, 645 F.2d 360 (5th Cir. 1981).

KPL respectfully submits that Mesa and Amici are requesting the Court below to engage in a redundant act. The Kansas Court agreed with the *Pennzoil* analysis, and in reliance thereon determined whether Mesa's contracts provide for a price increase.

Mesa admits that the sole disagreement between these parties is whether Mesa's contracts provide a sufficient mechanism for price escalation and whether the Kansas Court so held.[9] Petitioner's Reply Memo at 3-5. Mesa thus admits that the sole issue is one of state law for which jurisdiction for this Petition is lacking.

Respondent respectfully submits that the issue raised by the Petitioner's Question Presented, as supported by Amici, is not available in this action. The only issue which Mesa may raise is jurisdictionally insufficient for review in this Court, as the Commission had ordered in dismissing this action before.

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9. Mesa also argued before the Commission that "the only issues to be decided are related to whether Kansas contract law allows Mesa under the price escalator clause to receive the Section 102 rate." Appendix hereto at A-8.

CONCLUSION

For the reasons submitted herein, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX

UNITED STATES OF AMERICA
BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION

Docket No. RI79-30

THE KANSAS POWER AND LIGHT COMPANY

vs.

MESA PETROLEUM CO.

MOTION TO DISMISS

COMES NOW MESA PETROLEUM CO. (MESA) and requests that the complaint and petition for declaratory order filed by The Kansas Power and Light Co. (KPL) be dismissed for the following reasons: (1) the Commission's order of March 13, 1979, in Docket No. RM79-22 provides that the interpretation of existing intrastate contracts is subject to the parties and, in the event of disagreement, the state courts; and (2) the District Court of Grant County, Kansas, has prior jurisdiction over the issues raised by the complaint and petition for declaratory order.

I. INTRODUCTION

On May 28, 1970, MESA and KPL entered into a contract for the intrastate sale of natural gas from the Chase Group formation and the Council Grove formation in the Hugoton Gas Field in Kansas. Stemming from a lawsuit, the District Court of Grant County, Kansas, subsequently confirmed MESA's right under the contract to reserve a portion of its natural gas production for extraction of liquids and other processing. Thereafter, on February 13, 1976, MESA and KPL entered into a supplement to the

gas purchase contract for the purpose of allowing KPL to purchase 22 percent of the production which would otherwise have been reserved by MESA.

The price for the 22 percent of natural gas (so-called "New Gas") under the supplemental contract started at $1.52 per Mcf and was raised by a redetermination procedure to $1.92 per Mcf. In addition, the 22 percent of natural gas was subject to a price escalator clause.[1] As for the remaining 78 percent of natural gas, the price was left unchanged at 24.46 cents per Mcf and was not subject to the price escalator clause.

On November 9, 1978, the Natural Gas Policy Act (NGPA) was enacted. It prescribed certain prices for different categories of natural gas to be effective December 1, 1978. Under Section 105(b)(1) of the NGPA, the maximum lawful price for intrastate natural gas was the lesser of the price under the terms of the existing contract or the maximum price under Section 102. Therefore the price for the 22 percent of natural gas was subject to the terms of the supplemental contract under Section 105

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1. The price escalator clause in the contract appears as follows:

> (b) *Governmental Price Regulation*: If the Federal Power Commission or any successor governmental authority, or any Kansas regulatory or governmental authority, having jurisdiction in the premises shall at any time hereafter prescribe by law, rate proceeding, rule-making procedure or a comparable procedure any price applicable to any natural gas of any vintage produced from the Hugoton-Anadarko area and sold intrastate in Kansas or in interstate commerce, which is higher than the price or prices then provided in this Article I to be paid for New Gas delivered hereunder, then the price to be paid for New Gas remaining to be sold hereunder shall be increased to equal such regulated price. In that event, the increased price shall become effective as of the date of action of the governmental or regulatory authority establishing the regulated price, or its effective date, whichever is later (subject to the provisions of paragraph (c) below), and shall remain in effect until later changed in accordance with the pricing provisions of this Agreement.

(b)(1) and further restricted not to exceed the rate computed under Section 102.

Because the supplemental contract provided for the price of the 22 percent of natural gas to escalate to the highest rate prescribed by law, MESA requested KPL after December 1, 1978, to pay the Section 102 price under Section 105(b)(1). KPL declined to pay said rate and claimed that Section 105(b)(1) did not permit the Section 102 price to go into effect as a result of the escalator clause. The failure of KPL to pay the requested price gave MESA the option to terminate sales of natural gas.[2] However, because of the claims made by KPL, on February 16, 1979, at 9:20 a.m. CST, MESA filed a petition for declaratory relief in the District Court of Grant County, Kansas, to have the rights of the parties under the supplemental contract judicially interpreted.

Also on February 16, 1979, at 4:53 p.m. EST, KPL filed a document entitled "Complaint and Petition for Declaratory Order" with the Commission. In the document[3] KPL requested the Commission to protect its cus-

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2. Subject to a series of events which included non-action by the Kansas Corporation Commission on a request by KPL to pass through higher prices caused by escalation, MESA's right to terminate the contract is provided as follows:

> If KPL does not elect to pay such increase then Mesa shall have the option (to be exercised by written notice delivered to KPL not later than 30 days after the KCC shall have rejected any such pass-on by KPL) either (i) to terminate this Agreement insofar as it provides for the sale of New Gas to KPL hereunder, or (ii) to continue to receive the price being paid by KPL without giving effect to the increase; provided that the pricing provisions of this Agreement shall continue to be applicable thereafter regardless of Mesa's election to continue receiving such price.

3. Although the Commission has not provided Mesa with official notice of this document, counsel for KPL has provided a copy to Mesa's attorney. By filing this motion to dismiss, other procedural rights which might be available upon official notice should not be considered waived.

tomers from the termination of sales and to rule that MESA had misinterpreted the NGPA and was not entitled to the Section 102 price under Section 105(b)(1). KPL predicted [sic] its position on the Commission's Notice of Proposed Rulemaking and Public Hearing in Docket No. RM79-22,[4] and which was rescinded by the Commission in its Order of March 13, 1979.[5]

II. THE ORDER OF MARCH 13, 1979 IN DOCKET NO. 79-22

In Docket No. 79-22, the Commission issued an order dated March 13, 1979, which established final regulations amending and clarifying regulations under the NGPA and the Natural Gas Act. The order involved the effect of the NGPA on price escalator clauses in existing interstate and intrastate contracts. With regard to existing intrastate contracts, the Commission established that the interpretation of escalator clauses is a matter of interpretation for the parties. If the parties are unable to agree, the Commission provided that the state courts are to have residual power to make determinations as to whether escalator clauses are contractual authority to charge the maximum lawful prices under the NGPA. In this regard, the Commission stated:

> As a general matter, fixed price and indefinite price escalator clauses in existing intrastate contracts may

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4. Amendment and clarification of the Commission's Interim Regulations Implementing The Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act (Notice of Proposed Rulemaking and Public Hearing) issued in Docket No. RM 79-22. February 13, 1979.

5. Amendment and clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act (Order Adopting Final Regulations Amending and Clarifying Regulations Under the Natural Gas Policy Act and the Natural Gas Act) issued in Docket No. RM 79-22, March 13, 1979.

> permit escalation of the price under the contract in accordance with the terms of that contract. In a case where section 105(b)(1) of the Natural Gas Policy Act applies, escalator clauses may permit an increase in the contract price up to but not in excess of the current new natural gas price under section 102 of the Natural Gas Policy Act. Questions of contract interpretation are left, in the first instance, to the parties to the contract. In the event of their disagreement, the question should be left to state courts to resolve.[6]

Because MESA and KPL have not been able to agree as to the effect of the escalator clause in their existing intrastate contract, the state court is left with the responsibility of making a determination. Currently, the question of the effect of the escalator clause is before the District Court in Grant County, Kansas. As a result, KPL's complaint and petition should be dismissed and the questions surrounding the contract should be left to the Grant County District Court.

III. PRIOR JURISDICTION OF THE GRANT COUNTY DISTRICT COURT

On questions of contract law, the United States Supreme Court took the position that the Federal Power Commission (FPC) did not have primary jurisdiction. (See, *Texas Gas Transmission Corporation v. Shell Oil Company*, 363 U.S. 263 (1960)) In *Merle M. Rowan v. Allied Chemical Corporation*, 39 FPC 64 (1968), the FPC concurred with this position by acknowledging that it did not have primary jurisdiction over contract questions. It stated:

> It has been the Commission's policy to defer action on contract questions presented to it involving juris-

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6. Id at 53.

> dictional matters pertaining to natural gas which are pending in court. Such contract questions have been decided by the Commission only when neither party has sought a determination in an appropriate court. (Id at 66-67)

Presumably, the question of jurisdiction on contract issues has not changed by the transfer of authority from the FPC to this Commission.

As noted earlier, MESA filed a petition with the Grant County District Court to determine the effect of the escalator clause in its contract prior to the commencement of this action by KPL. (Attached is a copy of the petition and accompanying exhibits.) Because the Commission does not have primary jurisdiction over contract questions, the fact that the Grant County District Court assumed jurisdiction prior to the Commission should be grounds for dismissal of this action.

IV. CONCLUSION

For the above stated reasons, MESA prays that the complaint and petition in this docket be dismissed.

Respectfully submitted,

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. GP79-4

THE KANSAS POWER AND LIGHT COMPANY

vs.

MESA PETROLEUM COMPANY

SUPPLEMENT TO MESA'S MOTION TO DISMISS

On February 16, 1979, the Kansas Power and Light Company (KPL) petitioned the Commission for a declaratory order interpreting a price escalator clause in three intrastate contracts entered into with Mesa Petroleum Co. (Mesa). The clause appears as follows:

> (b) *Governmental Price Regulation*: If the Federal Power Commission or any successor governmental authority, or any Kansas regulatory or governmental authority, having jurisdiction in the premises shall at any time hereafter prescribed by law, rate proceeding, rulemaking procedure or a comparable procedure any price applicable to any natural gas of any vintage produced from the Hugoton-Anadarko area and sold intrastate in Kansas or in interstate commerce, which is higher than the price or prices then provided in this Article I to be paid for New Gas delivered hereunder, then the price to be paid for New Gas remaining to be sold hereunder shall be increased to equal such regulated price. In that event, the increased price shall become effective as of the date of action of the governmental or regulatory authority establishing the regulated price, or its effective date, whichever is later (subject to the provisions of paragraph (c) below), and shall remain in effect until later changed in accordance with the pricing provisions of this Agreement.

This clause falls within the Commission's order of March 13, 1979, in Docket No. RM 79-22. As a result, the contracts containing this clause are subject to interpretation by the parties. However, because the parties are in disagreement, the contracts are subject to interpretation by the Kansas courts in accordance with the order of March 13, 1979.

With regard to the Commission's docket herein, Mesa renews its motion to dismiss prior to a designation of this case to an Administrative Law Judge. Because the aforementioned price escalator provision is clear and unambiguous, no factual questions exists. The only issues to be decided are related to whether Kansas contract law allows Mesa under the price escalator clause to receive the Section 102 rate in the Natural Gas Policy Act of 1978. As recognized by the Commission, the issues surrounding the interpretation of the intrastate contract are matters for the Kansas courts. Consistent with this policy, Mesa has filed suit in the District Court of Grant County, Kansas, asking for declaratory relief and an interpretation of the escalator clause. This was done prior to the filing of the action docketed herein.

WHEREFORE, Mesa prays that the complaint and petition in this docket be dismissed.

Respectfully submitted,

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners:

Charles B. Curtis, Chairman; Georgiana Sheldon, Matthew Holden, Jr., and George R. Hall.

Docket No. GP79-4

Kansas Power and Light Company

v.

Mesa Petroleum Co.

ORDER DISMISSING PETITION FOR DECLARATORY ORDER

(Issued August 10, 1979)

This case involves a petition to the Federal Energy Regulatory Commission for a declaratory order interpreting sales contracts involving natural gas which would fall under section 105(b)(1) of the Natural Gas Policy Act of 1978 (NGPA). For the reasons set forth below, the Commission declines to interpret the contracts, and thus dismisses the petition for declaratory order.

In February of 1976 Kansas Power and Light Company (KPL) and Mesa Petroleum Co. (Mesa) entered into a "Supplemental Gas Purchase Contract." This contract and two others,[1] included identical escalation provisions[2]

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1. These contracts are for the sale of natural gas which is not subject to the jurisdiction of the Commission under the Natural Gas Act. For purposes of convenience, such contracts will be designated "intrastate contracts" in this order.

2. *Government Price Regulations*: If the Federal Power Commission or any successor governmental authority, or any Kansas regulatory or governmental authority, having jurisdic-

(Continued on following page)

which Mesa claims to constitute the contractual authority to charge and collect the maximum lawful price under section 102 of the NGPA.

Accordingly, Mesa has requested KPL to pay that price. KPL has refused to pay the higher price, asserting that the escalation provisions do not authorize the collection of the section 102 rate.

On February 16, 1979, KPL filed a complaint and petition for declaratory order.[3] In that petition, KPL claimed that the Commission has a duty to resolve these contracts. On March 30, 1979, Mesa filed a motion in which Mesa argued that since KPL's contractual questions were already before a court, and since the Commission does not have primary jurisdiction over contractual disputes such as these the Commission should dismiss KPL's complaint and petition for declaratory order. On April 13, 1979, KPL made a further filing entitled "Opposition to Motion to Dismiss and Motion for Expedited Consideration", in which KPL responded that the NGPA's statutory framework requires the Commission to resolve this dispute. On June

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Footnote continued—

tion in the premises shall at any time hereafter prescribe by law, rate proceeding, rulemaking procedure or a comparable procedure any price applicable to any natural gas of any vintage produced from the Hugoton-Anadarko Area and sold intrastate in Kansas or in interstate commerce, which is higher than the price or prices then provided in this Article I to be paid for New Gas delivered hereunder, then the price to be paid for New Gas remaining to be sold hereunder shall be increased to equal such regulated price. In that event, the increased price shall become effective as of the date of action of the governmental or regulatory authority establishing the regulated price, or its effective date, whichever is later (subject to the provisions of paragraph (c) below) and shall remain in effect until later changed in accordance with the pricing provisions of this agreement."

3. Earlier that same day, Mesa filed a petition for declaratory relief on the same issue in the District Court of Grant County, Kansas.

25, 1979, Mesa filed a supplement to its motion to dismiss, in which Mesa correctly cited Order No. 23, issued on March 13, 1979, in Docket No. RM79-22, for the proposition that the courts should resolve contractual disputes between the parties to an intrastate natural gas purchase contract.

The Commission adheres to the position taken in Order NO. 23, because (1) the Mobile-Sierra doctrine[4] does not apply to natural gas which is not subject to the Natural Gas Act,[5] (2) the NGPA does not explicitly require the Commission to resolve intrastate gas purchase contract disputes and (3) the doctrine of primary jurisdiction does not require that we resolve such disputes.

The doctrine of primary jurisdiction has been delineated in several Supreme Court cases.[6] The Commission recently discussed the doctrine in the Order issued on May 18, 1979, in Arkansas Louisiana Gas Company v. Frank F. Hall, *et al.*, Docket No. RI76-28 (Arkla Order). In that order the Commission determined that "whether the Commission should asert jurisdiction over contractual issues otherwise litigable in state courts, depends, . . . on these three factors . . . (1) whether the Commission possesses some special expertise which makes the case peculiarly appropriate for Commission decision; (2) whether there is a need for uniformity of the type of question raised by

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4. The Mobile-Sierra doctrine stands for the proposition that a rate-increase filing is ineffective if not supported by contractual authority *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *Federal Power Commission v. Sierra Pacific Power Co.* 350 U.S. 348 (1956); *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Division*, 358 U.S. 103 (1958).

5. *See* Order on Rehearing of Order No. 23, issued May 11, 1979 in Docket No. RM79-22.

6. *See e.g., Nader v. Allegheny Airlines*, 426 U.S. 240 (1976); *Ricci v. Chicago Mercantile Exchange*, 409 U.S. 289 (1973).

the dispute; and (3) whether the case is important in relation to the regulatory responsibilities of the Commission."

Concerning the first factor, the Commission does not have any greater expertise than the courts in interpreting escalation provisions in intrastate natural gas contracts. Were the Commission to resolve this kind of issue, its decision would be based upon the same principles of contract interpretation as a court would use. This being the case, a court would be free to make its own determination of the correct application of the appropriate legal principles.[7] Since the issues are within the conventional competence of the courts, the Commission has no responsibility to afford a forum for the resolution of intrastate contract disputes on the basis of agency expertise.[8]

The second factor, the need for uniformity, does not create a duty to provide a forum, because uniformity of interpretation of intrastate natural gas purchase contracts is simply not possible. The Commission believes that such contracts should be interpreted according to state contract law. Thus, the interpretation of a particular language would depend on the state law, which governs that particular contract. The same language may be interpreted differently under different state laws. Additionally, the "commercial context" of any particular contract may be different from that of another contract, thus requiring a different result for two contracts that use similar or identical language. See order on rehearing of Order No. 23 issued on May 11, 1979. Thus, the Commission's view is that since uniformity of intrastate contract interpretation

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7. *Texas Gas Transmission Corp. v. Shell Oil Co.*, 363 U.S. 263, 270 (1960).

8. A further reason for deferring to local courts is the fact that many parties to natural gas contracts cannot afford to come to Washington, D.C. to resolve contractual disputes.

is not possible, the goal of uniformity would not be furthered by resolving intrastate contract disputes.[9]

Finally, we must decide whether the resolution of this dispute by some other body than the Commission would have an adverse impact on our regulatory responsibilities. The NGPA and our regulations permit indefinite price escalation clause in intrastate contract to operate *according to their terms,* so long as they do not operate to raise the price above the NGPA maximum lawful price. *See* 18 C.F.R. 270.205(b)(1). The Commission has decided to defer to courts the resolution of questions of interpretation of such "terms" in intrastate contracts. Consequently, for the Commission to decline to resolve this intrastate contractual dispute will have no adverse effect on our regulatory scheme.

Since we find that we need not exercise jurisdiction under any of the three tests just discussed, we dismiss KPL's petition for a declaratory order.

After due notice by publication in the Federal Register, timely petitions to intervene were filed by the Kansas Independent Oil and Gas Association, the State Corporation Commission of the State of Kansas, the Associated Gas Distributors, and Northwest Pipeline Corporation. None of these petitioners requested a hearing. No further petitions to intervene, notices of intervention, or protests to the granting of the petition have been filed.

The Commission Orders:

(A) We deny the petition for declaratory order for the reasons stated above.

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9. Of course, uniformity is built into the system when federal questions are involved. State courts are bound to employ applicable federal law, and review to the United States Supreme Court is available for federal questions. *Pan American Petroleum Corp. v. Superior Court,* 366 U.S. 656, 665 (1961).

(B) The above listed petitioners to intervene are permitted to intervene subject to the rules and regulations of the Commission; *provided, however,* that participation of such intervenors shall be limited to matters affecting asserted rights and interests as specifically set forth in the petitions to intervenors, and provided, further that the admission of such intervenors will not be construed as recognition by the Commission that it might be aggrieved because of any order of the Commission entered in this proceeding.

By the Commission.
(S E A L)

Kenneth F. Plumb,
Secretary.

Opposition

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ALEXANDER L. STEVAS,
CLERK

No. 81-711

IN THE
Supreme Court of the United States
OCTOBER TERM, 1981

MESA PETROLEUM CO.,
Petitioner,
v.
THE KANSAS POWER AND LIGHT COMPANY, INC.,
Respondent.

BRIEF OF STATE CORPORATION COMMISSION OF THE STATE OF KANSAS IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI TO THE KANSAS SUPREME COURT

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QUESTION PRESENTED

Whether the indefinite price escalator clause in the Supplemental Contract between Petitioner Mesa Petroleum Co. and Respondent The Kansas Power and Light Co. was triggered under Section 105(b)(1) of the Natural Gas Policy Act of 1978, 15 USC § 3315, thus increasing the price to be paid under the contract to the Section 102 price, and thereby justifying termination of the contract.

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STATEMENT OF THE CASE

A. Introduction

The instant case involves the question of whether the establishment of ceiling prices for intrastate natural gas by the passage of the Natural Gas Policy Act of 1978 ("NGPA")[1] activated the indefinite price escalation clause contained in the Supplemental Contract between Petitioner Mesa Petroleum Co. ("Mesa") and the Respondent, The Kansas Power and Light Company, Inc., ("KP&L") thereby justifying Mesa's claim for higher prices and its attempted termination of the Supplemental Contract. For purposes of brevity, Respondent State Corporation Commission of the State of Kansas ("Com-

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[1] 15 U.S.C. 3301-3432.

mission") accepts the Statement of the Case contained in Mesa's Petition, except as clarified herein.

B. Facts

In its Statement of the Case, Mesa indicates that in its Motion for Rehearing, it pointed out to the Kansas Supreme Court the recent decision rendered by the United States Court of Appeals for the Fifth Circuit in *Pennzoil v. Federal Energy Regulatory Commission*,[2] which Mesa alleged supported its position that its attempted termination of the Supplemental Contract was lawful. Mesa further states that the Kansas Supreme Court nonetheless denied rehearing, leaving the implication that the Kansas Supreme Court ignored the *Pennzoil* decision.[3]

Such was not the case. The Kansas Supreme Court was aware of the *Pennzoil* decision and it dealt with the implications of that decision in its Opinion on Motion for Rehearing, where it stated:

> It is contended by movants that our opinion went beyond these holdings and is, in fact, contrary to the holding in *Pennzoil Co. v. Federal Energy Regulatory Com'n*, 645 F.2d 360 (5th Cir. 1981). We do not agree. The issue in *Pennzoil* was:
>
> > "May 'area rate clauses' in existing interstate gas purchase contracts escalate the contract price to the maximum lawful price provided in the Natural Gas Policy Act of 1978?" p.365.
>
> The circuit court stated:
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> > "The text of the statute itself, its legislative history, and the structure and policy of the NGPA do not preclude area rate clauses from escalating the interstate contract price to the

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[2] 645 F.2d 360 (May 20, 1981), petition for certiorari filed August 18, 1981, No. 81-340, U.S.L. Week 33133 (1981).

[3] Petition at 7.

maximum lawful NGPA price. *Nor does it, on the other hand, require such escalation.*" p. 372. Emphasis supplied.

As we interpret the N.G.P.Act it does not preclude escalation of prices under contract clauses up to N.G.P.Act ceiling prices. On the other hand, contrary to the assumption by MESA, the mere enactment of the N.G.P.Act did not activate price escalator clauses, such as the one in the present case, so as to escalate prices to the N.G.P.Act ceiling levels.[4]

REASONS FOR DENYING THE WRIT

I. The Requested Writ Should Not Issue Because the Opinion Below Rests Upon Independent And Adequate State Grounds.

Review will not be granted for judgments of state courts which rest on adequate non-federal grounds.[5] This principle has application in the instant case, and should be applied to deny the Writ requested.

The instant proceeding was commenced as, and remained throughout, a contract termination case. Mesa sought judicial approval of an attempted termination of the contract based upon the operation of an indefinite price escalation clause contained in its contract with KP&L. According to Mesa, the passage of the NGPA triggered this escalation clause, and thereby vested Mesa with the right to collect escalated prices for gas sold under the contract.[6] Under Mesa's rationale, when KP&L declined to pay these escalated prices, Mesa had the right to terminate the contract.

The Kansas Supreme Court concisely summarized the nature of this case in its statement of the issue presented. It said:

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[4] Petitioner's App. H, at 54a-55a.

[5] *Herb v. Pitcairn*, 324 U.S. 117, 65 S. Ct. 459, 89 L.Ed. 789 (1954).

[6] Petition at 5.

> The single question raised in this appeal is whether the indefinite price escalator clause in the supplemental contract was triggered under Section 105(b)(1) of the N.G.P.Act thus increasing the price to be paid under the intrastate contract to the Section 102 price. If the price was increased to the Section 102 price, Mesa was justified in terminating the supplemental contract and was entitled to the declaratory judgment. If the indefinite price escalator clause in the supplemental contract was not triggered under the N.G.P.Act the former contract price of $1.92 continued, and termination by Mesa was improper.[7]

In resolving the issue presented, the Kansas Supreme Court based its interpretation of the operation of the language contained in the indefinite price escalation clause of the contract. The analysis which led to this conclusion involved two steps. First, it reviewed the operation of the NGPA, and specifically Section 105(b)(1). The Kansas Supreme Court determined that under Section 105(b)(1):

> . . . the maximum lawful price under the section *shall be the lower of*—(A) the price under the terms of the existing contract to which the gas was subject on November 9, 1978, or (B) the maximum lawful price under Section 102 of the N.G.P.Act.[8]

The Kansas Supreme Court then reviewed the contractual language contained in the indefinite price escalation clause. It concluded that the mere passage of the NGPA was insufficient to warrant price escalation *under the terms of the contract.* As the Kansas Supreme Court stated:

> Since the indefinite price escalator clause in the contract was not triggered by the N.G.P.Act the attempted termination of the supplemental contract by

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[7] Petitioner's App. E at 33a.

[8] Petitioner's App. E at 35a.

> Mesa was not lawful and Mesa remains bound by the terms of the contract.[9]

This decision was based upon the interpretation of the contractual language, a fact which was reiterated by the Kansas Supreme Court in its Opinion on Motion for Rehearing, where it stated:

> In the original opinion we held (1) the indefinite price escalator clause contained in the gas purchase contract between the parties was not triggered by enactment of the Natural Gas Policy Act of 1978 (15 U.S.C. 3301, *et seq.* [1979]), (2) the contract price was not escalated, and (3) the attempted termination of the contract by Mesa was ineffective.[10]

In a clarification of its basic rationale, the Kansas Supreme Court stated that the mere establishment of ceiling prices due to the passage of the NGPA did not trigger the escalation clause as claimed by Mesa. As the Kansas Supreme Court interpreted that clause, specific prices must be prescribed before the clause is triggered. Once again, it concluded that the words of the indefinite price escalation clause did not, under the facts and circumstances, authorize the collection of the higher price claimed by Mesa. As a consequence, the attempted termination of the contract by Mesa was ineffectual.

Fundamentally, this case involves the interpretation of the meaning and operation of specific contractual terms contained in an intrastate gas supply contract. The opinion of the Kansas Supreme Court rests squarely on just such an interpretation, which is an adequate and independent non-federal ground for the decision rendered. Therefore, review of this state court judgment should not be undertaken.

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[9] Petitioner's App. E at 36a.

[10] Petitioner's App. H at 54a.

II. The Opinion Below Does Not Conflict With The Decision of the United States Court of Appeals for the Fifth Circuit.

Petitioner has alleged that a conflict exists between the decision of the Kansas Supreme Court in the instant case, and that of United States Court of Appeals for the Fifth Circuit in the case of *Pennzoil v. Federal Energy Regulatory Commission.* Specifically, Petitioner alleges that there is conflict between the two decisions over how Section 105(b)(1) operates.[11] This allegation is based upon erroneous analysis of these two decisions. The supposed conflict is illusory.

In the instant case, the Kansas Supreme Court was asked to determine the legality of an attempted termination of an intrastate gas supply contract. The attempted termination was predicated upon the operation of an indefinite price escalation clause contained in the contract, and the effect upon its operation occasioned by the passage of the NGPA. In reaching the conclusion that under the facts and circumstances of the case, no price escalation was authorized by the contract clause and that the attempted termination was ineffectual, the Kansas Supreme Court analyzed Section 105(b)(1) of the NGPA, and interpreted the terms of the indefinite price escalation clause contained in the contract.

In reaching its decision, the Kansas Supreme Court recognized that Section 105(b)(1) of the NGPA establishes the ceiling price for intrastate gas at the lower of the price under the terms of the contract to which the gas was subject on November 9, 1978, or the maximum lawful price under Section 102. The Kansas Supreme Court clearly understood that the NGPA permitted intrastate gas prices to escalate up to the Section 102 ceiling price, if the terms of the escalation clause contained in the contract authorized such an increase.

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[11] Petition at 8.

As the Kansas Supreme Court stated in defining the issue presented:

> The single question raised in this appeal is whether the indefinite price escalator clause in the supplemental contract was triggered under Section 105(b)(1) of the N.G.P. Act thus increasing the price paid under the intrastate contract to the Section 102 price.[12]

The Kansas Supreme Court concluded that in the instant case there was no price escalation under the terms of the price escalation clause contained in the contract as of November 9, 1978. This conclusion was based upon the terms of the escalation clause, which limited any escalation. It states:

> In that event, the increased price shall become effective as of the date of action of the governmental or regulatory authority establishing the regulated price, or the effective date, whichever is later . . . .[13]

Since the effective date of the ceiling prices established in the NGPA was December 1, 1978, under the terms of the contract no price escalation could occur on November 9, 1978. Thus, the Kansas Supreme Court concluded that termination of the contract could not be claimed based upon the November 9th passage of the NGPA.

The Kansas Supreme Court also analyzed the allegation by the Petitioner that sometime, somewhere, someone had paid the Section 102 price for intrastate, and this authorized the escalation to the Section 102 price. It reviewed the language contained in the indefinite price escalation clause and concluded:

> In its final brief filed in the district court, Mesa argued the indefinite escalator clause was triggered

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[12] Petitioner's App. E at 33a.

[13] Petitioner's App. E at 29a.

> by the payment of higher prices, not the enactment of the N.G.P. Act on November 9, 1978. In other words, the higher maximum prices were without doubt paid by some other purchasers and this triggered the raise to the price under Section 102 of the N.G.P. Act. *We find nothing in the contract to support such an argument.*[14] (Emphasis supplied.)

Lastly, in its Opinion on Motion for Rehearing, the Kansas Supreme Court dealt with the question of whether the creation of the scheme of multiple ceiling prices for gas under the N.G.P.A. was sufficient to trigger the subject escalation clause. This clause authorized price escalation if and when a governmental authority "prescribed" a price higher than that being paid under the contract.

The Kansas Supreme Court recognized that the passage of the NGPA had introduced a new concept, the ceiling price, and had eliminated the notion of specific prices being set by law. As the Court remarked:

> With the change in the law from regulated pricing under the Natural Gas Act to deregulation under the N.G.P. Act by setting ceiling prices, a different concept appeared. Prices were not prescribed by law. They were permitted to escalate under the terms of the various contracts not to exceed certain ceiling prices provided in the N.G.P. Act.[15]

The Kansas Supreme Court correctly concluded that under the terms of the contractual price escalation clause, the establishment of ceiling prices did *not* authorize the escalation of the price under the contract. As a consequence, the attempted termination was ineffectual.

In all of these analyses, the Kansas Supreme Court recognized that Section 105(b)(1) of the NGPA permits contractual escalator clauses to operate to increase

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[14] Petitioner's App. E at 35a.

[15] Petitioner's App. H at 56a.

gas prices when their terms authorize such increases, and that under Section 105(b)(1) the maximum lawful price for intrastate gas is the Section 102 price. It stated:

> Both the terms of the new statute and its legislative history demonstrate that the prices prescribed in Title I of the N.G.P. Act are ceiling prices. Contractual provisions governing the purchase and sale of natural gas are not superseded or nullified unless they should provide for price escalation in excess of the statutory ceilings.[16]

The Kansas Supreme Court re-emphasized its understanding of this fundamental concept in its Opinion on Motion for Rehearing, when it stated:

> As we interpret the N.G.P. Act it does not preclude escalation of prices under contract clauses up to the N.G.P. Act ceiling prices.[17]

Thus, contrary to the assertions of the Petitioner, the Kansas Supreme Court certainly understood that intrastate gas prices could escalate if the contractual terms authorized it, so long as the escalation did not exceed the statutory ceiling price.

In contrast to the instant case, *Pennzoil v. FERC* dealt with a completely different section of the NGPA under a different factual setting. It involved the prices to be paid for interstate gas, rather than intrastate gas as in the instant case. Also, it was a proceeding to review the certain orders promulgated by the FERC, rather than a dispute over the interpretation of specific contractual language, as was the case in the instant matter. The *Pennzoil* case involved a challenge to the FERC Orders 23 and 23-B, by which the agency established review procedures for interstate gas vendors

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[16] Petitioner's App. E at 27a.

[17] Petitioner's App. H at 55a.

who were claiming that their Section 104, 106(a), 108 or 109(a)(2) gas was entitled to be sold at an increased price.

The Fifth Circuit Court did touch upon that section of the NGPA implicated in the instant case. In discussing the operation of area rate clauses in interstate contracts, the Fifth Circuit Court did digress to discuss for purposes of illustration the operation of Section 105(b)(1). It stated:

> Sections 105 and 106(b) apply to gas under an intrastate contract that was in effect on the NGPA's date of enactment. These are the only NGPA provisions that expressly make the contract price the maximum lawful price. If the contract price on November 9, 1978, was greater than the section 102 new gas price, then under section 105(b)(2) the maximum lawful price is that November 9th contract price until the section 102 price catches up to the inflation adjusted contract price. If, on the other hand, the price on November 9th was less than section 102, under section 105(b)(1) the maximum lawful price is the current price provided for under the terms of the contract as long as it does not exceed the section 102 price. Therefore, in the latter case, the intrastate contract price may escalate from its November 9th level to the Section 102 level, *provided that the contract has a sufficient escalation mechanism.*[18]

While explicating the operation of Section 105(b)(1) in order to make a point, the Fifth Circuit Court opined that Section 105(b)(1) permits intrastate gas prices to escalate, but only if the contract terms are sufficient to authorize such a price increase.

The decision of the Kansas Supreme Court does not conflict with these propositions, but in fact relied upon them in its analysis of the instant case. Concerning the

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[18] 645 F.2d 360, 374-75 (1981).

possibility of price increases under existing intrastate contracts, it stated:

> Contractual provisions governing the purchase and sale of natural gas are not superseded unless they should provide for price escalation in excess of statutory ceilings.[19]

With regard to the need for sufficient contractual provision to authorize the escalation in price, the Kansas Supreme Court stated:

> The single issue raised in this appeal is whether the indefinite price escalator clause in the supplemental contract has triggered under Section 105(b)(1) of the N.G.P. Act, thus increasing the price to be paid under the contract to the Section 102 price.[20]

The degree to which the Kansas Supreme Court understood the holding in the *Pennzoil* case is demonstrated by the fact that in the companion case to the instant matter, *Energy Reserves Group v. KP&L*,[21] the Kansas Supreme Court quoted the language of the *Pennzoil* case regarding the operation of Section 105(b)(1), and the need for sufficient contractual language to justify price escalation.

There is no conflict between the opinion of the Kansas Supreme Court in the instant case, and that of the Fifth Circuit Court of Appeals in the *Pennzoil* case. Both stand for the proposition that Section 105(b)(1) allows price escalation under existing intrastate gas contracts, but only if sufficient contractual language exists to authorize such a price increase. In the instant case, the Kansas Supreme Court concluded that the contractual language was insufficient. No reason exists for this Court to assume jurisdiction to resolve a conflict which does not exist.

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[19] Petitioner's App. E at 27a.

[20] Petitioner's App. E at 33a.

[21] —— Kan. —— (1981), reprinted in Petitioner's App. J.

III. The Opinion of the Kansas Supreme Court Conforms With Congressional Policy Established in the NGPA.

Petitioner has alleged that the opinion of the Kansas Supreme Court in the instant case conflicts with Congressional policy as contained in the NGPA.[22] This assertion is in error.

By passing the NGPA, Congress did not intend to abrogate the pricing provisions contained in existing intrastate contracts. Section 105(b)(1) stated that the maximum lawful price for intrastate gas under contract would be the lower of the price under the terms of the contract to which the gas was subject on the date of the Act or the Section 102 price. In this section Congress was preserving by statute the pricing provisions contained in these contracts, including any existing escalation clauses. Congress intended to allow the actual terms of the contract to control the price to be paid for intrastate gas.

This policy of preserving existing contractual pricing mechanisms was stated in the legislative history of the NGPA. As explained in the Statement of the Managers:

> The maximum lawful price [under Section 105] depends upon the contract price in effect on the date of enactment of this Act. If the contract price in effect on the date of enactment is less than the new gas ceiling price, the maximum lawful price for any subsequent month is the lower of (1) the price under the terms of the existing contract in effect on the date of enactment, or (2) the new gas price. *Thus, the price under the contract may escalate through the operation of both fixed price escalator clauses and indefinite price escalator clauses in existence as of the date of enactment, but the price may not exceed the new gas price.*[23] (Emphasis supplied)

Congressional policy, as contained in the NGPA, is that contractual pricing provisions contained in intra-

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[22] Petition at 14.

[23] H.R. Rep. No. 95-1752, 95th Cong., 2d Sess. 82 (1978).

state gas contracts will be preserved, and will operate to set the price paid for gas under their terms. The FERC recognized this policy in promulgating its final regulations for the implementation of Section 105(b)(1). While modifying the language contained in its interim regulations to more closely track the statutory language, the FERC stated:

> . . . [W]e have revised § 271.502(a)(1) to track the appropriate statutory language. This change should allay the apprehensions of those commentators who feared that fixed or indefinite price escalator clauses in contracts were abrogated by § 271.502 (a)(1).[24]

While it was the intent of Congress to preserve existing contractual pricing mechanisms, including escalation clauses, it was not the intent or policy of Congress that the mere passage of the NGPA would trigger price increases under existing escalator clauses. On this point there can be no confusion. As stated by the Conferees:

> The conferees do not intend that the mere establishment of the ceiling prices under this Act shall trigger indefinite price escalator clauses in existing intrastate contracts. Once natural gas is sold pursuant to the ceiling prices under this Act, such clauses would be activated as limited by this section.[25]

The FERC recognized this Congressional policy directive when it was first grappling with the implementation of the NGPA. In the explanatory statement contained in FERC Order 23, the following quote appears:

> As a general matter, fixed price and indefinite price escalator clauses in existing intrastate contracts may permit escalation of the price under the contract in accordance with the terms of that contract. In a case where Section 105(b)(1) of the Natural Gas

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[24] Federal Energy Regulatory Commission, Interim Regulations Implementing the Natural Gas Policy Act of 1978, 43 F.R. 56448, CCH Vol. II, Paragraph 30,062, at 30,162 (December 1, 1978).

[25] H.R. Rep. No. 95-1752, 95th Cong., 2d Sess. 82 (1978).

> Policy Act applies, escalator clauses may permit an increase in the contract price up to but not in excess of the current new natural gas price under Section 102 of the Natural Gas Policy Act. Questions of contract interpretation are left, in the first instance, to the parties to the contract. In the event of their disagreement, the question should be left to state courts to resolve.[26]

The Fifth Circuit Court of Appeals has also endorsed this analysis of the Congressional policy as embodied in the NGPA. In the *Pennzoil* case, while commenting upon the operation of Section 105(b)(1) for purposes of illustration, the Fifth Circuit Court explained:

> Sections 105 and 106(b) apply to gas under an intrastate contract that was in effect on the NGPA's date of enactment. These are the only NGPA provisions that expressly make the contract price the maximum lawful price. If the contract price on November 9, 1978, was greater than the section 102 new gas price, then under section 105(b)(2) the maximum lawful price is that November 9th contract price until the section 102 price catches up to the inflation adjusted contract price. If, on the other hand, the price on November 9th was less than section 102, under section 105(b)(1) the maximum lawful price is the current price provided for under the terms of the contract as long as it does not exceed the section 102 price. Therefore, in the latter case, the intrastate contract price may escalate from its November 9th level to the section 102 level provided that the contract has a sufficient escalation mechanism.[27]

And finally, the Kansas Supreme Court explicitly recognized the congressional directive to preserve existing pricing mechanisms in intrastate gas contracts.

> Both the terms of the new statute and its legislative history demonstrate that the prices prescribed in Title I of the N.G.P. Act are ceiling prices. Con-

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[26] 44 F.R. 16895, CCH Vol. II § 30,040 (March 13, 1979).

[27] 645 F.2d 360, 374-75.

> tractual provisions governing the purchase and sale of natural gas are not superseded or nullified . . . .[28]

The Supreme Court of Kansas also made clear its understanding of the Congressional directive that the mere passage of the NGPA was *not* intended to trigger price increases under existing escalator clauses. The Kansas Supreme Court stated:

> As we interpret the N.G.P. Act it does not preclude escalation of prices under contract clauses up to N.G.P. Act ceiling prices. On the other hand, contrary to the assumption of MESA, the mere enactment of the N.G.P. Act did not activate price escalator clauses, such as the one in the present case, so as to escalate prices to the N.G.P. Act ceiling levels.[29]

The Kansas Supreme Court stated in its initial opinion, and in its Opinion on Motion for Rehearing, that the mere passage of the NGPA did not trigger price escalation, and that any price increase must be based upon the express contract terms. This holding is in total conformity with every major interpretation of the policy which Congress sought to establish in the NGPA generally, and Section 105(b)(1) specifically. This includes the Statement of the Conferees, the orders and regulations of the FERC, and the opinion of the Fifth Circuit as stated in the *Pennzoil* case. Petitioner's assertion that the decision of the Kansas Supreme Court in this case conflicts with Congressional policy is ill founded.

CONCLUSION

Petitioner seeks review of a state court opinion which decided a contractual dispute. In this decision, the Kansas Supreme Court determined that the indefinite price escalation clause had not been triggered by the passage of the NGPA, that the price of gas sold under the contract had not been escalated, and that the attempted

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[28] Petitioner's App. E at 27a.

[29] Petitioner's App. H at 55a.

termination of the contract by Mesa was ineffective. These conclusions were based upon the facts and circumstances of the case, and the interpretation of the meaning and operation of the indefinite price escalation clause contained in the contract.

In reaching these conclusions, the Kansas Supreme Court based its ultimate decision upon its interpretation of the language contained in the disputed contract clause. The opinion rendered by the Kansas Supreme Court does not conflict with the *Pennzoil* opinion, but in fact cites that decision with approval. The decision of the Kansas Supreme Court in the instant matter conforms with the stated policy of Congress as embodied in the NGPA and every major pronouncement which has interpreted that policy.

Petitioner has failed to put forward any substantial ground which would warrant review of this state court decision. For these reasons, the petition for the writ of certiorari should be denied

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Petitioner's Reply Brief

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IN THE

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OCTOBER TERM

MESA PETROLEUM CO.,
Petitioner,

v.

THE KANSAS POWER AND LIGHT COMPANY, INC.,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Kansas

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PETITIONER'S REPLY MEMORANDUM

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PETITIONER'S REPLY MEMORANDUM

The bulk of KPL's reasons for denying a Writ of Certiorari in this case deal with issues tendered to the Kansas Supreme Court by KPL but left undecided by the court. First, KPL suggests that the Kansas Legislature has retroactively recreated a contract that was terminated four months prior to the legislative action.[1] Second, KPL would have a party and a state supreme court bound by a trial court decision in a different action where the

[1] KPL Brief at 12. As KPL notes, the retroactive application of the Kansas Natural Gas Price Protection Act, Kan. Stat. Ann. Section 11-1401, *et seq.* (Supp. 1980) was sustained in the *Energy Reserves* case as applied to an attempted contractual termination occurring subsequent to the Act's passage. Whatever the merits of that determination, the issue potentially involved in this litigation, a prior termination, is quite different.

party to be bound by res judicata was not a party to the action.[2] Third, KPL would find Mesa and KPL bound at a specific point in time by a temporary, erroneous, and quickly withdrawn FERC regulation.[3] Each of these issues is interesting and upon remand each will be open to the Kansas Supreme Court to consider. But in the present posture of the case, that court has not considered them, and they have nothing to do with the Petition for Certiorari.

When KPL turns from the issues the Kansas Supreme Court did not decide to the one it did, there is more agreement between the parties than one might suppose. Both parties agree that Congress did not intend to prevent price escalations under intrastate contracts.[4] Both agree that the NGPA should be interpreted to authorize price escalation where parties have provided for it.[5] Both parties agree that the intent of the parties should govern the contractual interpretation.[6] Where the disagreement begins is at what the Kansas Supreme Court did. Not surprisingly, KPL would have the decision rest on state grounds.

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[2] KPL Brief at 13.

[3] KPL Brief at 16.

[4] KPL Brief at 4-5.

[5] Mesa and KPL have an on-going relationship. As such one would expect that in negotiations each is willing to back away from a position that it might take in litigation in order to reach an acceptable compromise. Thus as KPL accurately notes, Brief at 11-12, footnote 9, Mesa is receiving price increases from KPL under other clauses providing for fixed escalation and price redetermination. That KPL would rather pay a modest price increase within the allowable ranges of the Kansas Natural Gas Price Protection Act, see footnote 1 *supra*, rather than risk termination of a long-term contract is hardly surprising. It is equally comprehensible that Mesa has no interest in abandoning other price increases to which it is legally entitled simply because the current litigation is pending.

[6] KPL Brief at 12.

KPL states the decision "turns on the intent of the parties and the operation and interpretation of the contracts between them." [7] Just what was the parties' intent? The Kansas Supreme Court, affirming a trial court finding, stated "that the parties intended that if Congress increased the maximum prices for which gas might be sold that this would fulfill the reference in Article I(b) to action by any successor governmental authority." [8] Since Congress did just that, why didn't the price escalate in conformity with the parties' intent? Our answer is simple: because the Kansas Supreme Court misunderstood and misconstrued Section 105(b)(1) to preclude escalation.

KPL's answer is more difficult to flesh out. Given what it has asserted, the answer must be "the operation and interpretation of the contracts." [9] That is, despite the parties' intent that prices escalate, the parties used language ineffective to achieve their intent. Here KPL can and does [10] note the language in the decision denying the motion for rehearing that "the contract as drawn by the parties did not provide for the payment of the highest price allowed by law and this Court will not rewrite the contract to authorize that result." [11] What the contract lacked was not the appropriate intent, but a "sufficient mechanism" for escalation.[12] This KPL argues (as does the Kansas Corporation Commission) is an issue of state law.

Were the decision of the Kansas Supreme Court based solely on the existing corpus of Kansas contract law, then

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[7] KPL Brief at 12.

[8] App. E at 34a.

[9] KPL Brief at 12.

[10] KPL Brief at 11.

[11] App. H at 56a.

[12] KPL Brief at 9; App. H at 55a.

of course it would rest on state law grounds.[13] But the lack of a "sufficient mechanism" in the contract was not based on principles of state contract law, but on an erroneous view of federal law.[14] What this case has been

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[13] Assuming that the determination to test the decision on state grounds, placed in the context of the litigation, were not taken solely for the purpose of evading the applicable federal mandate. See footnote 32 of the Petition for Certiorari.

[14] Reduced to its essential elements the indefinite price escalation provision in the Mesa-KPL contract provides as follows:

(a) If any successor governmental authority (to the Federal Power Commission)

(b) Prescribes by law

(c) Any price applicable to any natural gas sold intrastate in Kansas or in interstate commerce which is higher than the price then provided in the contract,

(d) Then the price to be paid under the contract shall be increased to such regulated price on the date of the governmental action or its effective date, whichever is later.

Applying the facts of this case and the holdings of the Kansas Supreme Court to the elements of the contract as set out above produces the following result:

(a) The Kansas Supreme Court expressly held in the *Energy Reserves* case that Congress was "a successor governmental authority" to the Federal Power Commission. (App. J at 70a). Furthermore, the opinion below notes that it is reasonable to assume that the parties intended "successor governmental authority" to refer to Congress. (App. E at 34a).

(b) There is no question but that the NGPA is a "law." Additionally, the opinion below states in three separate places that the NGPA "prescribed" maximum ceiling prices. (App. E at 26a, 27a and 29a). Furthermore, the opinion below expressly held as follows:

> "It is reasonable to assume that the parties intended if Congress increased the maximum prices for which gas might be sold that this would fulfill the reference in Article I(b) to action [i.e. prescribing by law] by any successor governmental authority." App. E at 34a).

[Footnote continued on page 5]

about from the beginning is how the enactment of the NGPA affected indefinite price escalator clauses in existing intrastate gas contracts. Federal law and state law are both relevant to that question and the Kansas Supreme Court's decision reflects the operation of both bodies of law. Thus the reason the parties' intent was thwarted was that federal law, as the court saw it,[15] precluded the

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[14] [Continued]

This finding was strongly reaffirmed in connection with a comparable price escalation provision in the *Energy Reserves* case. (App. J at 70a).

(c) There is no question but that Section 102 of the NGPA provided for prices applicable to natural gas sold in Kansas which were in excess of the price then provided in the contract.

(d) There is no question but that the later of the date of the governmental action and its effective date was December 1, 1978.

It is clear from the above analysis, which is based upon the court's opinions, that under the terms of the Mesa-KPL contract, the price to be paid for natural gas was to be increased to the NGPA Section 102 price effective December 1, 1978. Where the Kansas Supreme Court erred was in interpreting Section 105(b)(1) of the NGPA in a manner which precluded price escalations which were otherwise contractually authorized under the Mesa-KPL contract. The court below erred in interpreting federal law, not in interpreting a contract provision.

[15] The Kansas Supreme Court did not apply its interpretation of Section 105(b)(1) to the price redetermination clause in the *Energy Reserves* case even as it was holding that Section 105(b)(1) blocked escalation under the Energy Reserves-KPL indefinite price escalator clause. It is unclear whether the court was *sub silentio* limiting its Section 105(b)(1) holding to indefinite price escalation clauses or whether the court did not realize that its interpretation of Section 105(b)(1) would have precluded escalation under the redetermination clauses at issue there. The briefs were already in and so the point may have escaped the court's attention. Furthermore, since the court found the price redeterminations blocked by the Kansas Natural Gas Price Protection Act there was neither need nor incentive for anyone to point out to the court how its interpretation of Section 105(b)(1) would affect price redetermination clauses.

price escalation. The court was perfectly explicit on how federal law operated to prevent the escalation in the context of the Mesa-KPL contract. Using language applicable to *any* contract, not just those at issue,[16] the court wrote:

> The maximum lawful price under Section 105(b)(1) was either the price under the terms of the existing contract on November 9, 1978 ($1.92 per Mcf), or the maximum price under Section 102 of the N.G.P. Act for the month of December, 1978 ($2.078 per million Btu's) whichever is lower. Clearly, the contract price on November 9, 1978 is the lower and remains the maximum lawful price under Section 105(b)(1).[17]

To this KPL has but one response. That was in the original opinion, not in the opinion denying the motion for rehearing.[18] But the subsequent opinion did not repudiate the original opinion. It stated that escalation was possible and that *Pennzoil* was correct, but it left its contrary interpretation of Section 105(b)(1) intact. In so doing, the court continued its erroneous interpretation of the contract because of its erroneous interpretation of federal law. The same error was then perpetuated on the same day as the opinion denying the motion for rehearing when the court interpreted an entirely different indefinite escalator clause in the *Energy Reserves* case.

> Section 105(b)(1) of the NGPA fixes the maximum lawful price of intrastate gas as the lower of the Section 102 price or "the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date . . . ." We hold that under the terms of the government price escalator clause

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[16] The November 9 contract price of $1.92 per Mcf is the only item specific to Mesa and KPL.

[17] App. E at 35a.

[18] KPL Brief at 10.

> in these contracts, and under the applicable section of the NGPA, the November 9th gas price (which was lower than the Section 102 price) did not escalate. The rationale expressed in the *Mesa Petroleum Company* case is fully applicable here.[19]

KPL is correct that we address the original opinion in our Petition for Certiorari. The reason is simple. The Kansas court continues to rely on that interpretation of Section 105(b)(1). It remains the law of Kansas; the rationale applies to other parties in other cases; and it is that construction of Section 105(b)(1) which other courts handling intrastate gas contracts will consider.

At this point KPL has but one response. Essentially it is that the decision does not wholly negate Congressional intent; it is but a limited conflict with *Pennzoil*; and a small Balkanization of federal energy policy. Thus KPL states that the Kansas Supreme Court "expressly noted in its opinion on rehearing that other clauses, including fixed price escalator clauses, price redetermination clauses and indefinite price escalator clauses triggered by other events would function in Kansas."[20] Even conceding that the Kansas Supreme Court will follow KPL's interpretation[21] by ignoring what the court did in particular and concentrating on what it said in general when the court deals with future cases, the pregnant omission is obvious. Whatever "triggered by other events" may mean, it does not mean triggered by governmental action because that is the *Mesa-Energy Reserves* holding. KPL admits this and thus used the distinguishing phrase "other clauses."[22] No matter that Congress intended they

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[19] App. J at 71a.

[20] KPL Brief at 11 (emphasis deleted).

[21] As part II of our Petition for Certiorari demonstrates, the decision below is far broader than KPL's attempted narrowing.

[22] KPL Brief at 11.

should operate;[23] no matter that FERC and the Fifth Circuit have like views.[24] The Kansas Supreme Court has nullified all governmental action indefinite escalation clauses and KPL is so stating.

We find this concession incredible. If we read it correctly, then, taken in conjunction with KPL's admission that Congress did not intend to prevent price escalations,[25] it is a virtual concession that the judgment below is wrong as a matter of federal law. Perhaps in this posture KPL's choice to devote the bulk of its Brief to issues not addressed below becomes explicable. Since the decision below cannot be supported on the ground the court used, KPL suggested some alternative grounds.

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[23] Thus the House and Senate Managers stated the "price under the contract *may escalate* through the operation of both fixed price escalator clauses and *indefinite price* escalator clauses in existence as of the date of enactment, but the price may not exceed the new gas price," H.R. Rep. No. 95-1752, 95th Cong., 2d Sess. 82 (1978) (emphasis added). The full quotation is printed in the Petition for Certiorari at 15.

The Kansas Corporation Commission has quoted from a later portion of the same Report to the effect that the Conference Committee did not intend that "mere Establishment" of ceiling prices would trigger indefinite price escalator clauses. KCC Brief at 13. (Although the KCC cites to the same page as we do, that is a typographical error; their quote comes from the very bottom of page 83). As the *Pennzoil* analysis of the Conferee's "mere establishment" point demonstrates, 645 F.2d at 378, the KCC quote relates to "most favored nation" clauses as opposed to area rate or governmental regulation clauses such as those in the instant case. "Most favored nation" clauses have their own separate history and are inapplicable here. In the context of this litigation it is not the mere passage of the NGPA that Mesa contends triggered the escalation clauses. Rather it is the passage of the NGPA combined with a contract whereby the parties have exhibited the requisite intent that passage of such an Act would operate to escalate the prices. As the Kansas Supreme Court has found, App. E at 34a, the parties here had that requisite intent.

[24] See the Petition for Certiorari at 8-14.

[25] KPL Brief at 4-5.

Under these circumstances possibly the best disposition of the case is to grant the Petition for Certiorari and then consider a summary reversal to free the Kansas Court of its mistaken and Balkanizing view of federal law and allow the court to address what should be the dispositive issues in the litigation.

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NO. 81-711

IN THE SUPREME COURT
OF THE UNITED STATES
OCTOBER TERM, 1981

MESA PETROLEUM COMPANY,
PETITIONER
V.
THE KANSAS POWER & LIGHT COMPANY, INC.,
RESPONDENT

ON PETITION FOR WRIT OF CERTIORARI
TO THE SUPREME COURT OF KANSAS

MOTION FOR LEAVE TO FILE BRIEF
AND
BRIEF OF AMICUS CURIAE,
THE LEGAL FOUNDATION OF AMERICA

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IN THE SUPREME COURT OF THE UNITED STATES
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THE KANSAS POWER & LIGHT COMPANY, INC.
RESPONDENT

ON PETITION FOR WRIT OF CERTIORARI
TO THE KANSAS SUPREME COURT

MOTION OF THE LEGAL FOUNDATION OF AMERICA FOR LEAVE TO FILE AMICUS CURIAE BRIEF, SUPPORTING PETITION FOR WRIT OF CERTIORARI

The Legal Foundation of America moves for leave to file the annexed amicus curiae brief and would respectfully show the Court as follows:

1. Identification of Amicus Curiae: The Legal Foundation of America ("LFA") is a nonprofit corporation supporting the operations of a public interest law firm. Among other goals, LFA seeks to preserve economic freedom, to remove unreasonable regulation, and to protect the principle of limited government. It has supported the market system of resource allocation and opposed unreasonable regulation in such diverse industries as commercial lending, uranium mining, broadcasting, health care services, and oil and gas production, among others. All litigation undertaken by LFA is approved by its Board of Trustees, a majority of whom are attorneys.

2. Amicus Curiae's Experience in Natural Gas Escalation Clause Cases: This year, LFA attorneys have been involved in cases arising out of Kansas, Wyoming, Oklahoma, Colorado and Texas, concerning the construction of natural gas clauses simi-

lar in operation to the one at issue in this case. One LFA attorney has served as an expert witness in federal litigation dealing with the economic effects of natural gas contract clauses. LFA has particular expertise in the issues before the Court in this case.

3. Interest of Amicus Curiae: In one of LFA's cases, in Oklahoma, the decision of the Kansas Supreme Court that is under review in this case has been cited in opposition to positions taken by LFA. LFA was thus induced to focus upon the effects of the decision immediately after it was announced. *See* Brief of Appellees in Response to Amicus Brief of the Legal Foundation of America, *Oxley v. Oklahoma Gas & Electric Co.* (No. 55,655; Okla. S. Ct. 1981). As a result, LFA is familiar with the potential nationwide impact of the decision below and may be able to assist the Court in developing that issue fully.

4. Desirability of Amicus Curiae Brief: The inclusion of escalation clauses in natural gas contracts is essential to rational pricing. The decision of the Kansas Court, however, would prevent such clauses from serving their proper function. The reasons for such clauses, and the effect of the Kansas decision upon them, are succinctly stated in this brief. Furthermore, a major question this Court will confront in deciding whether to grant certiorari concerns the extent of the Kansas decision's impact upon other disputes and other litigants. This brief deals with that issue, showing that the decision will likely be cited in disputes that will inevitably arise in every gas-producing State. Finally, this brief shows how and why the opinions of the Kansas Court are inconsistent with federal law. These are issues upon which amicus briefing in this case is desirable.

5. Reasons for Believing that Existing Briefs May Not Present All Issues: Though the petition for certiorari is clearly drafted by careful and competent counsel, it necessarily concentrates upon the complex statute at issue (the Natural Gas Policy Act) and upon the decision of the court below. There is need for other views to show the full impact of the decision of the Kansas Supreme Court as a reason for granting the writ. In particular, LFA's experience in natural gas contract litigation in

several gas-producing States enables it to add analysis in this regard.

6. Position of LFA as Amicus Curiae: The decision of the Kansas Supreme Court is confusingly reasoned. With deference to that Court, this Amicus believes it simply misinterpreted what Congress said. As a result, it articulated a view of the NGPA that is at variance with the language of that Act, with Congessional reports, and with the policy underlying the Act. Unless there is a grant of the writ of certiorari by this Court, this confusing and erroneous decision will be cited in cases that will arise in every gas-producing State, and it will ultimately have adverse effects upon gas supply, particularly in the interstate market that supplies the non-gas-producing States of the North and East.

7. Consent of Parties, or Requests Therefor: Amicus Curiae timely requested consent of the parties. Petitioner Mesa Petroleum Company has consented, and its letter expressing consent is lodged with the Court. This Motion is necessary because of the refusal of one party, Respondent Kansas Power & Light Company, to grant consent. The letter of Kansas Power & Light Company is lodged with the Court for the purpose of showing its stated reasons for refusing consent. Amicus curiae notes that KPL's reasons include the assertion that there has been a "proliferation" of interest in the case below, as well as the observation that it has received "numerous" inquiries as to consent to amicus participation and concerning the case. It is submitted that these assertions, rather than justifying the requiring of a motion for leave by a prospective amicus curiae, instead confirm the views of this Amicus concerning the great importance of the case.

FOR THESE REASONS, LFA requests that it be granted leave to file the annexed amicus curiae brief.

Respectfully submitted,

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NO. 81-
IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1981

MESA PETROLEUM COMPANY,
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V.
THE KANSAS POWER & LIGHT COMPANY,
RESPONDENT

BRIEF OF AMICUS CURIAE, THE LEGAL FOUNDATION OF AMERICA, SUPPORTING GRANT OF WRIT OF CERTIORARI

INTEREST OF AMICUS CURIAE

Amicus curiae adopts the statement in the Motion preceding this brief as showing the interest of amicus curiae.

STATEMENT OF THE CASE

Natural gas is America's cheapest, cleanest and most efficient fuel for fixed-location uses. It is generally sold on very long-term contracts at the instance of purchasers, who desire assured supply. Unfortunately, however, the supply is depletable. It has been clear to both buyers and sellers for many years that gas prices, which have been artificially suppressed by regulation, must rise. Therefore, the negotiation of natural gas contracts has, for several years, required the setting of fair prices over long terms in a rising market.

There are two ways in which a buyer and seller can agree on fair prices in such a situation. One theoretical method is by a constant price over the life of the contract. But such a price would have to be set very high, well above initial market prices, to reflect the fact that it would remain well below market at the end of the contract term. Therefore, nearly all modern natural

gas contracts adopt a different approach: They contain what are known as escalation clauses. The measure of the contract price may be prices paid for natural gas by other purchasers, or prices paid by the same purchaser to other producers, or prices prevailing for other fuels such as heating oil, or sequentially rising governmentally regulated price ceilings. All of these common measuring methods serve the same purpose: that of providing an index by which the price at issue can be tied to approximate market levels as market prices rise. In this manner, producers can be induced to commit supply for long terms, and purchasers can be assured of prices similar to those paid by others in the market.

The case at bar involves a contract between Mesa Petroleum Company as seller and Kansas Power & Light Company as buyer. These parties agreed upon a clause tying the price to federally regulated ceilings. In addition to receiving the usual benefits of long-term supply at competitive prices, KPL received a clear and unusual additional benefit in exchange. Specifically, Mesa had the right to extract 22 per cent of the gas stream as ethane (which could be sold elsewhere at higher price), and it agreed to refrain from doing so, explicitly in light of the escalation clause.

The mid-to-late 1970's were a time of great turmoil in natural gas supply. In certain parts of the country, there were curtailments and service interruptions, causing severe economic dislocation and danger to life and health in the States of the North and East. There was a flight of people and industry to States with plentiful gas. Since the cause of the turmoil was federal regulation of prices at artificially low levels in the interstate market, the gas-producing States, in which intrastate sales were unregulated, had available supply, and they benefitted at the expense of others. In 1978, Congress passed the Natural Gas Policy Act ("NGPA"), which is the statute at issue in this case. This Act has as its purpose the phased deregulation of most natural gas. Also, in the NGPA, Congress for the first time imposed pricing limits upon sales within the boundaries of a single State (intrastate sales), in order to bring gas-producing and non-gas-producing States in line. In intrastate sales, section 105 of the NGPA governs. It allows escalation clauses in existing intrastate con-

tracts to operate, up to NGPA limits. The contract between Mesa and KPL is an intrastate transaction and is covered by this provision.

In the instant litigation, however, the Kansas Supreme Court adopted a construction of the NGPA that permanently precludes escalation of the contract between Mesa and KPL, freezing the price at its pre—NGPA level for the remainder of the contract term. This holding has the effect of converting an indexed price, in mid-stream, into a constant-price one, after the purchaser has received the benefit of the bargain and without providing the seller with the consideration exchanged for it. More importantly, the opinion of the Kansas Supreme Court rests upon a misinterpretation of the NGPA that contravenes both its language and its purpose.

I. THIS DECISION, IF FOLLOWED, WOULD CREATE ARTIFICIALLY DEPRESSED PRICES, ENCOURAGE WASTEFUL CONSUMPTION, AND DISCOURAGE SUPPLY IN GAS PRODUCING STATES, TO THE DISADVANTAGE OF OTHER STATES.

The clause of the contract here at issue was not drafted from scratch by the parties. Instead, it is a variation of a clause approved years ago by the Federal Power Commission for interstate gas sales, called an "area rate" or "FPC price protection" clause. Its approval by the FPC led to its widespread use in intrastate as well as interstate sales. It is therefore to be found not merely in this transaction, but in contracts affecting literally thousands of wells in Nebraska, Colorado, Wyoming, Oklahoma, Louisiana, Texas, Arkansas, North Dakota, South Dakota, Idaho, Montana, and other gas producing states, as well as Kansas.

The purpose of the clause, simply put, is to make the price reflect the true market value of the commodity over the life of the contract. No fairer way of doing so from the purchaser's point of view can be found than indexing the price to govern-

mentally regulated price ceilings. The decision of the Kansas Court in this case, however, cuts off the effect of all such clauses, converting negotiated and agreed-to indexed price contracts into constant-price ones in mid-stream. Because it does so on the basis of interpretation of the federal NGPA, which is applicable in all States, the decision would, if followed, artificially depress prices in every gas-producing State, with serious adverse effects upon long-term gas supply for the non-gas producing States of the North and East.

There is substantial danger that, unless this Court grants certiorari and corrects the Kansas Supreme Court's misreading of the NGPA, the decision may indeed be followed elsewhere. This amicus curiae is aware of pending cases in a number of gas-producing States presenting the same issue. In at least one of these cases in which this amicus curiae is also a participant, the Kansas Court's opinion has already been cited as a reason for refusing to follow contract terms. See Supplemental Brief of Appellees in Response to Amicus Brief of The Legal Foundation of America, Oxley v. Oklahoma Gas & Electric Co. (No. 55,655; Okla. S. Ct., 1981)(pending). The issue must, of necessity, arise in every State with intrastate gas sales at some time, and it can be expected that this decision will be cited in every such case. In fact, even Respondent KPL recognizes the intense and widespread interest this case has created. In correspondence with Amicus Curiae, KPL has stated that the Kansas Court's interpretation of the NGPA resulted in a "proliferation" of briefing by adversely affected parties in the oil and gas industry. It notes that it is still receiving "numerous" inquiries about the case.*

The Kansas Court's decision is rendered even more ironic by the fact that if the contract were for interstate sales of gas, the escalation would be allowed, the contract would be enabled to rise to NGPA ceilings, and there would be neither encourage-

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* For a description of such correspondence, which resulted from amicus' request for consent to file, see the Motion for Leave to File preceding this Brief.

ment of wasteful consumption nor discouragement of supply. See, e.g., Pennzoil Company v. FERC, 645 F.2d 360 (5th Cir. 1981). For the same reason, if the contract were an intrastate one in a State following the Pennzoil decision, which conflicts directly with the Kansas decision here, it would not be precluded from escalation. The decision below gives a local and special benefit to Kansas consumers, not available to interstate consumers. If followed, the decision will generally grant a discriminatory preference for consumers in gas producing states, thereby defeating the precise purpose of the NGPA and threatening long-term gas supply for the non-gas-producing States of the North and East.

Economists are in surprisingly unanimous agreement about the harmful effects of the resulting depression of prices below market. See, e.g., P. Samuelson, Economics 385-89 (6th ed. 1964).* The practice suppresses conservation, encourages wasteful and uneconomical uses of the resource, leads to premature exhaustion of available supply, discourages capital formation, and decreases production, creating shortages. It also decreases development of alternate fuels, since it induces consumers to rely upon the lower-cost fuel whose price is suppressed. These effects will have different impact in different regions of the country. That is precisely what happened in gas-producing States during the mid-to-late 1970's and led to the radical change of federal natural gas policy represented by the NGPA.

Of course, artificial depression of prices in gas producing

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* See also R. Dorfman, Prices and Markets 17-18 (1967); J. Orr & D. Savage, Economics in American Society 290-92 (1970); A. Gitlow, Economics 361-67 (1962); A. Alchian & W. Allen, Exchange & Production: Competition, Coordination & Control 93-98 (2d ed. 1977). For works of energy economists to similar effect, see A. Merklein & C. Hardy, Energy Economics 20-22 (1977); J. Griffin & H. Steele, Energy, Economics & Policy (1980); P. Starratt, The Natural Gas Shortage & the Congress 37-38 (1974); J. Darmstadter, Conserving Energy 81-82 (1975).

States might be a necessary effect of the separation of powers, *if* the decision below correctly reflected Congress' expression of federal policy. But the decision below contravenes the very foundations of the NGPA and will create confusion, regional discrimination, and the precise conditions the NGPA was enacted to prevent, unless this Court grants certiorari.

II. THE KANSAS COURT'S DECISION IS BASED ON A MISREADING OF THE NGPA.

Although the NGPA is a comprehensive statute, the Kansas Court's decision turns upon a misreading of a single sentence in section 105 of the Act. That sentence provides, in the context of this case, that the applicable price is to be "the price under the terms of the existing contract . . . as such contract was in effect on such date [i.e., November 9, 1978]."

This pertinent phrase is simple. But semantically, it is capable of being read in two different ways. First, one could read it to mean that the *price* in effect on November 9, 1978 is to be frozen forever, without change. That dubious reading can be reached by considering "on such date [November 9, 1978]" as modifying the words, "the price." Alternatively, one can read this statutory language to mean that the *contract* in effect on November 9, 1978, *together with its schedule of price increases,* is to be preserved. This reading can be reached by considering "on such date" as modifying the words, "existing contract."

The Kansas Supreme Court settled on the first of these inter-

---

* Stated more fully, the section provides that the price is to be the *lower* of either (1) the price under the terms of the existing contract or (2) the price set by section 102, which sets a ceiling price for newly discovered gas. NGPA section 105. Under the interpretation adopted by the Kansas Court, the first alternative was, and always would be, lower than the section 102 price, and so this Brief focusses on the language quoted. It is the semantics of that phrase that control the outcome.

pretations, fixing the price forever at the level of November 9, 1978. It stated, "The maximum lawful price . . . was either the price under the terms of the existing contract on November 9, 1978 ($ 1.92 per mcf), or the maximum price under section 102, whichever was lower."Opinion, Mesa Appendix E, at 35a. The court thus took the *price* in effect on November 9, 1978 (which happened to be $ 1.92), not the *contract* in effect on that date, and since $ 1.92 was lower than the section 102 price, the Court made that the price forever. This interpretation of the NGPA was dispositive of the issue for the Kansas Court. Although its opinion contains other discussion, all else is background.

For several reasons, fixing the *price* forever at the November 9, 1978 level is not a reasonable interpretation. First, it transposes the statutory language; "on such date [November 9, 1978]" is juxtaposed with "contract" as Congress wrote the sentence, not with "price." Secondly, if Congress had intended to freeze prices without escalation at November 9, 1978 levels, a much simpler sentence could have been used. There would actually be no need to refer to the contract at all. Third, the effect of this reasoning is to cut off all escalations for the indefinite future, regardless of their mechanism, and to fix the price irrespective of market level, inflation or industry changes. It is crystal clear that this result was not what Congress intended. NGPA provides for phased deregulation (as even the Kansas Court recognized), and the Kansas Court's reasoning leading to permanently frozen prices is not its purpose at all.

III. THE KANSAS COURT'S DECISION CONTRAVENES THE NGPA POLICY OF PHASED DEREGULATION.

A. Escalation Clauses Serve Valid Purposes and Are Essential to Rational Pricing of Natural Gas.

The reason for the inclusion of escalation clauses in natural gas contracts was given succinctly by Edward Neuner, a recog-

nized authority on the industry, as early as 1960:

> Ironically enough, the main pressure for the use of long-term purchase contracts—probably one of the major imperfections in gas field markets, leading to higher prices—has not come from the gas producer. It has come from pipe-line buyers desirous of assuring the availability of gas supplies in order to finance their projects . . . . Even when contract prices were not firm, and in spite of the realization that they might soon increase, pipe-line buyers have sought long-term purchase agreements. At least gas supply problems would thereby be resolved, on terms comparable to those paid by others.
>
> . . . [T]he interest of sellers in some mechanism which would raise contract prices—as field prices rise—is not difficult to appreciate.

E. Neuner, The Natural Gas Industry 265-66 (1960). In other words, if gas were sold as are most other commodities—in "one-shot" transactions, or even one-year transactions—there would be no need for such clauses. But since purchasers such as KPL require commitment of supply, fair pricing cannot be attained without them.

The benefit to the purchaser from escalation clauses is clear. Empirically, economists have found that lower initial price, lower overall prices, longer term, and greater supply are to be obtained by a contract containing an escalation clause. See P. MacAvoy, Price Formation in Natural Gas Fields 326-27 (1962). MacAvoy states that contracts containing escalators had "significantly lower [initial] prices than those without one." Id. Neuner explains that escalation clauses are "as much a part of the total consideration in a purchase transaction as the price schedule." The parties trade price increases [initially] for . . . certain contract clauses." These clauses "meet . . . basic needs." E. Neuner, supra, at 266-69.

In fact, most commodities that are sold on long-term contracts in a rising market are rationally sold in a similar manner.

The Federal Home Loan Bank Board has just approved the use of Variable Rate Mortgages, which are functionally indistinguishable from natural gas escalators. See Variable Mortgages Get an OK, Newsweek, May 4, 1981, at 64. The reason for use of these escalators in long-term loans is that many sellers of mortgage money (i.e., lenders) are unable or unwilling to take the risk of lending in today's economy at a constant rate unless it is set unaffordably high. Floating interest rates indexed to the prime rate have been in use in commercial transactions for years. Similarly, most long-term commercial leases contain escalators. These may be tied to prices for other items such as expenditures of the lessor, or they may be tied to tenants' sales. Most other energy sources that are sold on long-term contracts, such as coal, are to an increasing degree contracted for by indexed prices. Recently, a major commercial solar-energy installation was contracted for, by the use of an agreement containing an escalation clause modelled on natural gas contracting practices. Newsweek, supra. It is economically sound for contract prices thus to reflect current market values. Otherwise, pricing will induce a misallocation of resources. Simply put, if one buys an increasingly valuable commodity on a long-term contract, one must either pay market value over the life of the contract or one must pay a very high initial rate to reflect the seller's forebearance of the increase in price that would otherwise occur over the contract years.

In a case in which the purchaser has received greater supply at lower initial prices by agreeing to an escalation clause, cutting off the escalation in midstream—as did the Kansas Supreme Court in this case—is particularly inappropriate. An analogous case would be presented, for example, by a home purchaser on a graduated payment mortgage who, having received a lower initial interest rate by a greeing to a gradually increasing rate, later seeks to avoid the deferred increase. In this case, it is quite clear that the purchaser, KPL, received benefit, and that the seller, Mesa, gave up a right to receive higher prices for liquids it had the right to extract. After the supply has thus been assured, it is as unfair as it is unlawful to freeze the price at the November

9, 1978 level permanently.

B. Congress, in Enacting the NGPA, Recognized the Proper Functions of Escalation Clauses.

It is clear that Congress recognized the value of indefinite price escalators when it enacted the NGPA. For example, the Conference Committee Report on the final bill contains the following (emphasis added):

> *Intrastate contracts in existence on the day of enactment of this Act shall be sanctified,* provided that:
>
> . . .
>
> if the contract price is below the new natural gas ceiling price on the date of enactment of the Act, *the contract may escalate, under the terms of the contract, to the applicable new natural gas ceiling price* if the contract so permits.

Natural Gas Pricing Conference Agreement, H.R. 5289 (NGPA), June 15, 1978. The explanation of the Congress stands in sharp contrast to the approach of the Kansas Supreme Court, which does not "sanctify" existing contracts nor honor the parties' intent to escalate.

The Joint Explanatory Statement of the Committee on Conference contains the following treatment of intrastate contracts (emphasis added):

> If the contract price in effect on the date of enactment is less than the new gas ceiling price, the maximum lawful *price for any subsequent month is the lower of (1) the contract price, or (2) the new gas price. Thus, the contract may escalate* through the operation of both fixed escalator clauses and indefinite price escalator clauses, *but the price may not exceed the new gas price.*

Joint Explanatory Statement at 27. The approach of Congress—

that of using the "contract price" for "any subsequent month" up to the limit of the new gas price—is inconsistent with the Kansas Supreme Court's opinion, which uses (and freezes) solely the contract price as of November 9, 1978. The Kansas Court simply misunderstood what Congress intended.

IV. THE KANSAS COURT'S OPINION ON DENIAL OF REHEARING ENHANCES THE NEED FOR REVIEW BY THIS COURT.

A. The Opinion Denying Rehearing Contains Additional Misconstructions of Federal Law, Which Will Compound the Frustration of Congress' Intent Brought About by the Original Opinion Unless This Court Grants Review.

The Kansas Court's opinion denying rehearing erroneously states that the NGPA is "different" from previous federal law in that it provides only ceiling prices, while previous regulation, according to the Kansas Court, established "regulated prices" that were prescribed by law. Opinion Denying Rehearing, Mesa Appendix at 56a. In so stating, the Court not only reaffirmed its previous error, but indicated that it had misinterpreted the historical basis of federal natural gas regulation.

Previous regulation under area and national rates did not require regulated rates to be followed in the sense of "fixed" prices, as the Court below seemed to believe. Like the NGPA, previous regulation set ceiling prices. There was nothing in previous law that prevented contracting parties from setting a price below the applicable ceiling if they intended to do so. See, e.g., Permian Basin Area Rate Cases, 390 U.S. 747 (1968); Southern Louisiana Area Rate Cases, 428 F.2d 414 (5th Cir. 1970). Although the NGPA does differ from previous regulation in many respects, in this regard, contrary to the Kansas Court's statements, it is identical.

Certainly, this reasoning of the Kansas Court, based as it is upon a misinterpretation of federal law, does not provide an ad-

equate independent ground for decision. Furthermore, the use of this nonexistent difference as a means of interpreting the NGPA does not "clarify" the issue. If followed, the Kansas Court's reasoning in this regard would frustrate the Congressional intent underlying the NGPA's policy of phased deregulation, since it would lead to the anomalous conclusion that the most common kinds of escalation clauses, though effective before the NGPA, became ineffective to cause escalation after the NGPA and merely resulted in a permanent, below-market price freeze at pre-NGPA levels. That interpretation of federal law, which is the essence of the Opinion Denying Rehearing, directly contravenes the result reached elsewhere. Pennzoil Company v. FERC, 645 F.2d 360 (5th Cir. 1981). Thus the further misinterpretation of the federal regulatory system contained in the Opinion Denying Rehearing not only fails to clarify the issue but actually increases the need for review by this Court.

B. The Opinion Denying Rehearing Reaffirms the Erroneous Reading of the NGPA Contained in the Original Opinion.

The substance of the Kansas Court's opinion on rehearing is contained in its last paragraph. The Court's square holding was to "decline to grant a rehearing." The Court added, "We adhere to our original opinion except as herein clarified." Thus the effect of the Opinion Denying Rehearing, except to the extent that it rests upon an additional error of federal law in its comparison of regulatory ceilings before and after the NGPA, is to reaffirm the reasoning based on federal law contained in the original opinion—including its misreading of section 105.

CONCLUSION

The opinion of the Kansas Supreme Court is directly based on the NGPA. But it is a clear misreading of the NGPA. It contradicts the language of the NGPA, it is inconsistent with Congress' own explanations of the Act, and it contravenes the pol-

icy of phased deregulation that even the Kansas Supreme Court recognized was the motivation for enactment of the NGPA.

If allowed to stand, this decision will not determine merely the rights of the parties to the present dispute. It will be cited in cases that will inevitably arise in every gas producing State from North Dakota to Louisiana. It will, if followed in those States, artificially depress prices in the intrastate market by freezing them at pre-NGPA levels, with adverse and discriminatory results in the natural gas market nationwide.

If only for the purpose of clarifying this enormously important issue, this honorable Supreme Court should grant the writ of certiorari.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I , David Crump, hereby certify that I have accomplished service of this Motion and Brief prior to filing by depositing 3 copies hereof in the central U.S. Post Office at Houston, Texas, first-class postage prepaid, addressed to counsel of record for each party, as follows: Barry F. Cannaday & Jeffrey Glen Shrader, Mesa Petroleum Co., Box 2009, Amarillo, Tx. 79189, and Jerome T. Wolf & Basil W. Kelsey, Spencer, Fane, Britt & Browne, 1000 Power & Light Bldg., 106 W. 14th St., Kansas City, Mo. 64105, in accordance with Rule 28.3 of the Rules of this Court, on the date below written.

Amicus Brief

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No. 81-

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1981

MESA PETROLEUM CO.,
Petitioner,
v.
THE KANSAS POWER AND LIGHT COMPANY, INC.,
Respondent.

Petition for a Writ of Certiorari to the Kansas Supreme Court

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MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE AND BRIEF OF AMICI CURIAE, PETROLEUM, INC., PICKRELL DRILLING COMPANY, McCOY PETROLEUM COMPANY, AND KANSAS INDEPENDENT OIL AND GAS ASSOCIATION, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE

COME NOW Kansas Independent Oil and Gas Association ("KIOGA"), Petroleum, Inc., Pickrell Drilling Company, and McCoy Petroleum Company and move the Court for leave to file the attached brief *amici curiae* in this case, pursuant to Supreme Court Rule 36. The consent of the attorney for the petitioner has been obtained. The consent of the attorney for the respondent was requested, but refused.

The interest of the *amici* natural gas exploration and production companies arises from the fact that they produce and sell natural gas in the Kansas intrastate gas market under pre-April, 1977, contracts containing various definite price

escalator clauses, indefinite price escalator clauses, and price redetermination clauses, the intended and proper application of which is placed in serious jeopardy by the Kansas Supreme Court's interpretation of the intrastate gas price ceiling in Section 105(b)(1) of the Natural Gas Policy Act of 1978 ("NGPA") [15 U.S.C. § 3315(b)(1)] to freeze affected contract prices as of November 9, 1978.

The interest of *amicus* KIOGA arises from the fact that it is a voluntary association, consisting of approximately one thousand (1,000) members who are oil and gas producers, drillers, and petroleum geologists in Kansas, many of whom are also selling natural gas that will be affected by the Kansas Supreme Court's erroneous interpretation of Congressional policy, as reflected in Section 105(b)(1) of the NGPA.

Petitioner Mesa in the instant case approaches the question of the Kansas court's interpretation of the NGPA from the perspective of the provisions in its own contract. The Kansas court's erroneous interpretation of the NGPA intrastate price ceiling will, however, affect Kansas producers selling gas under a wide variety of pricing provisions not addressed by petitioner. The impact of the Kansas court's reading of the NGPA on such contracts is considered in the Brief of *Amici.*

The brief of *amici* considers two other issues that are not addressed in the Petition for a Writ of Certiorari: (1) the anomaly created by the Kansas Supreme Court's interpretation of the NGPA Section 105 when one considers the interrelation of Subsections (b)(1) and (b)(2); and (2) the interpretations placed upon Section 105 by the Kansas Legislature and the Kansas Corporation Commission that are inconsistent with the interpretation of the Kansas court.

Given the breadth of the impact of the Kansas decision and the breadth of the interests represented by these *amici,* it is believed that their research and analyses will be of benefit to the Court in determining the need to grant the petition for certiorari herein. *Amici,* therefore, request that the Court

accept and consider the attached Brief in Support of the Petition for a Writ of Certiorari.

Respectfully submitted,

/s/ Robert L. Howard

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BRIEF OF AMICI CURIAE, PETROLEUM, INC., PICKRELL DRILLING COMPANY, McCOY PETROLEUM COMPANY, AND KANSAS INDEPENDENT OIL AND GAS ASSOCIATION, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

INTEREST OF AMICI CURIAE

The salient facts in the instant case are summarized in the Statement of the Case set out in the Petition for a Writ of Certiorari. *Amici* state that they are or represent small independent producers of natural gas that sell gas under intrastate contracts containing price adjustment provisions of the type that were not before the Kansas Supreme Court herein but that are nevertheless affected by the court's reading of

the Natural Gas Policy Act of 1978 (hereinafter "NGPA"). [15 U.S.C. §§ 3301-3601.]

The effect of the Kansas Supreme Court's interpretation of NGPA Section 105(b)(1) [15 U.S.C. § 3315(b)(1)] is to set a ceiling price for intrastate natural gas that was under contract on the date of the enactment of the NGPA at the specific contract price that had been in effect on November 9, 1978, if it was lower than the maximum lawful price under Section 102 of the NGPA for "new gas." [Appendix to Petition for Certiorari (hereinafter "Cert. Appendix"), p. 35a.]

NGPA Section 105(b)(1) applies to contracts under which intrastate gas was being sold for less than the Section 102 [15 U.S.C. § 3312] new gas price when the NGPA was passed and provides in pertinent part:

> (b) Maximum lawful price —
>
> (1) General Rule — Subject to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of —
>
> (A) the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date; or
>
> (B) the maximum lawful price, per million Btu's computed for such month under section 3312 of this title (§ 102 relating to new natural gas).
>
> [15 U.S.C. § 3315.]

Section 105(b)(2) provides the NGPA ceiling price for intrastate gas that was being sold for more than the Section 102 price at that date. [15 U.S.C. § 3315.]

In applying petitioner Mesa's indefinite price escalator clause and determining the maximum lawful price thereunder, the Kansas court interpreted the NGPA Section 105(b)(1) reference to November 9, 1978, as meaning the contract price which had been completely effective as of that date, thereby determining the maximum lawful price for intrastate gas which could be applied during the six-year term of the NGPA.

> The maximum lawful price under Section 105(b)(1) was either the price under the terms of the existing contract on November 9, 1978 ($1.92 per mcf), or the maximum price under Section 102 of the N.G.P. Act for the month of December, 1978 ($2.078 per million BTU's), whichever is lower and remained the maximum lawful price under Section 105(b)(1). [Cert. Appendix, p. 35a. (Holding reaffirmed in *Energy Reserves Group v. Kansas Power and Light Company*, Kansas Supreme Court Case No. 52,677, July 17, 1981, Cert. Appendix, p. 71a.]

Under the Kansas court's interpretation of Section 105(b)(1), unless each of a contract's price adjustment mechanisms, of whatever variety, were written so that all were completely effective on November 9, 1978, the price adjustment mechanism (escalator clause) could have no effect, and the maximum lawful price for such contracts is effectively frozen for six years at the price which had been in effect immediately prior to November 9, 1978.

Although the contracts of *amici* contain price adjustment mechanisms different from the specific indefinite price escalator clause at issue herein, the contracts of *amici* are emasculated, contrary to the intent of the parties thereto and the drafters of the NGPA, by the Kansas court's reading of Section 105 of the Act. Indeed, any price adjustment mechanism that could otherwise be triggered by the NGPA, or NGPA-related events, and many that would be triggered by unrelated events (such as the mere passage of time in a periodic definite price escalator clause) are threatened by the Kansas court's interpretation of Section 105. The reference to November 9, 1978, in NGPA Section 105(b)(1), when given a fair reading, is nothing more than a recognition of the need for a cut-off date for the consideration of amendments to the "terms" of pre-NGPA intrastate contracts for purposes of computing the maximum lawful price for gas sold under such contracts. A review of the effect of that interpretation on such standard contract price adjustment mechanisms, the teaching of the section's legislative history, and the interpretation of Section 105 by the Fifth Circuit and several governmental authorities,

including the Kansas Legislature, indicates that the Kansas Supreme Court has misinterpreted the NGPA and highlights the importance of granting the petition for certiorari herein.

ARGUMENT AND AUTHORITIES

1. The Effect of the Kansas Supreme Court's Reading of NGPA Section 105 on Standard Price Adjustment Mechanisms in Natural Gas Purchase Contracts Indicates that the Kansas Court has Misinterpreted the NGPA.

Amicus McCoy Petroleum Company, for example, has an affected intrastate contract with Northern Natural Gas Company (hereinafter "McCoy/Northern Contract," pertinent portions of which are attached hereto as Appendix "A") containing several standard price adjustment provisions that appear to be negated by the Kansas court's reading of NGPA Section 105. In Article XII A(b), the parties agreed to a one cent per year price increase:

> (b) Commencing January 2, 1975, and extending through January 1, 1976, and for each succeeding one year period thereafter, the price will be increased one cent (1.0¢) over the contract price for the preceding price period. [Appendix A, p. A-1.]

Beginning with January 1, 1979, the one cent escalation would take the contract price above the price that was in effect on November 9, 1978, and would thus exceed the "lower of" interpretation placed on the NGPA Section 105(b)(1) maximum lawful price by the Kansas court.

The McCoy/Northern Contract contains two other standard price adjustment provisions that are inconsistent with the Kansas court's reading of Section 105. Paragraphs B and C of Article XII contain price escalator clauses that are known as "Area Rate" and "Favored Nations" clauses, respectively. [Appendix A, p. A-2.] The Area Rate clause in Paragraph B provides, in pertinent part, as follows:

> Any other provision in this Agreement to the contrary notwithstanding, if the Federal Power Commission or any other successor governmental authority having

> regulatory jurisdiction over wellhead sales of natural gas for resale in interstate commerce shall at any time hereafter *prescribe or approve for* the area in which the dedicated acres are situated a just and reasonable rate for the wellhead sale of natural gas of any vintage which is higher than the total price specified in Articles VII and XII and which is applicable to gas of similar quality and on comparable terms and conditions to those herein specified, the Seller may give Buyer written notice thereof and when such notice is given the total price specified in Articles VII and XII shall be automatically increased to equal such higher just and reasonable rate effective as of the date such notice is given or the date such higher price is prescribed . . . [Appendix A, p. A-2. Emphasis added.]

This clause provides for escalation effective upon the giving of written notice by McCoy to Northern of the triggering event — here the prescription or approval in the NGPA of a higher just and reasonable rate for new natural gas. Since McCoy could not give notice of a price prescribed or approved by the NGPA until it was actually passed on November 9, 1978, McCoy could not give written notice until after November 9, 1978, and under the Kansas court's construction of NGPA Section 105, McCoy is deprived of the benefit of the escalation clause negotiated by the parties.

The Favored Nations Clause of Paragraph C in the McCoy/Northern Contract is similarly negated. It provides, in pertinent part:

> It is further agreed between Buyer and Seller that at any time during the term of this Contract, should Buyer contract and pay a higher price for wellhead gas produced from formations shallower than the top of the Viola formation in Harper, Rice, Reno, McPherson, Harvey, Kingman, Barber, or Sedgwick Counties, Kansas, then Buyer agrees during such time as such higher price is being paid by Buyer to other parties, to pay Seller such higher price for the gas delivered to Buyer by Seller. [Appendix A, p. A-2.]

Since Northern would not be contracting for and paying the higher prices permitted under the various price ceilings of the NGPA [*See*, 15 U.S.C. § 3312 ("new gas") and § 3318 ("stripper

well gas").] until after its effective date of December 1, 1978, McCoy is deprived of the benefit of this clause by the Kansas court's reading of Section 105.

Amicus Petroleum Incorporated has an affected contract with the Kansas Power and Light Company (hereinafter "Petroleum/KPL Contract," pertinent portions of which are attached hereto as Appendix "B") containing a standard "Price Redetermination" provision entitling the seller to cause the contract price to be "redetermined" every two years. It provides, in pertinent part:

> 7.1 SELLER shall have the option to cause the price being paid for its gas by Buyer to be redetermined every two years, beginning in 1977. . . .
>
> 7.2 Within the same one hundred twenty (120) days following SELLER's request for a price redetermination, the parties shall mutually redetermine the price by considering three (3) contracts under which the highest prices are actually being paid for flowing gas ninety (90) days prior to the date the redetermined price is to be effective. [Appendix B, p. B-1.]

Beginning with the first two-year contract anniversary date after November 9, 1978, anything but a downward price redetermination would be inconsistent with the Kansas Supreme Court's reading of NGPA Section 105(b)(1) as limiting the maximum lawful price for intrastate gas to "the price" that was in effect as of November 9, 1978.

Notwithstanding the Kansas Supreme Court's assertion in its opinion on rehearing that its interpretation of the NGPA does not preclude escalation of prices "provided the contract has a sufficient escalation mechanism" [Cert. Appendix, p. 55a], a review of standard price adjustment provisions reveals that the Kansas court's interpretation of NGPA Section 105 completely negates such provisions because none of them could anticipate the date of November 9 for passage of the NGPA and thereby make November 8, 1978, the contractual triggering date. It is apparent, therefore, that unless the NGPA was intended by Congress to impose a price freeze of contract

prices existing and in effect as of November 9, 1978, throughout the six-year term of the NGPA, the Kansas court has misread and misapplied the reference in NGPA Section 105 to November 9, 1978. With further reference to the Kansas Court's assertion, *amici* state their complete agreement with petitioner's observation in footnote thirty-two of its petition for ceriorari that only an attenuated reading of the Kansas court's Opinion on Motion for Rehearing could infer a state law rationale for the court's decision. *Amici* would stress that even under such a reading of the Opinion on Motion for Rehearing, there would be a fundamental flaw in the court's opinion based on an erroneous interpretation of the NGPA. The Kansas court erroneously states that "[t]he contract provides for escalation if and when a governmental authority shall 'prescribe by law' any price which is higher" and that "under the N.G.P. Act by setting ceiling prices a different concept appears. Prices were not prescribed by law." [Cert. Appendix, p. 55a.] Assuming that the Kansas Court meant to provide a state law ground for its decision, it would have to be based on an incomplete and misstated quotation of the contract provision at issue herein in order to conclude that the NGPA did not "prescribe by law, rate proceeding, rule-making procedure or a comparable procedure *any price applicable to any natural gas of any vintage produced from the Hugoton-Anadarko area* . . . which is higher . . . ." [Mesa Contract, Article I(b), *see*, Cert. Appendix, p. 29a. Emphasis added.] An NGPA "ceiling price" is certainly "any price" prescribed by law, and it thus becomes clear that under any reading of the Kansas court's Opinion on Motion for Rehearing, the question boils down to a misinterpretation of the NGPA.

II. The Kansas Court's Interpretation of NGPA Section 105(b)(1) Fails to Give Meaning to Each Word in That Subsection and Is Inconsistent with the Balance of Section 105.

The Kansas court's difficulty with NGPA Section 105 is found not in the application of ambiguous or poorly-drawn contract language. Rather, the difficulty has its genesis in the

failure to give meaning to all of the words in Subsection (b)(1) and to read that Subsection to make sense when read with the balance of Section 105.

The language that has apparently caused the Kansas court's misinterpretation is found in the first half of the "lower of" maximum lawful price equation set out in Subsection (b)(1), which reads as follows:

> (A) the price *under the terms of the existing contract, to which such natural gas was subject* on November 9, 1978, as such contract was in effect on such date; . . . [15 U.S.C. § 3315(b)(1)(A). Emphasis added.]

The Kansas court has given this language a reading that, in effect, deletes the italicized portion set out above — as if Congress had chosen instead to say "the price on November 9, 1978." Congress obviously intended to give meaning to the underlined language and that intent is accomplished only if November 9, 1978, is read to identify the specific contract terms that are to be considered in computing an NGPA maximum lawful price for intrastate gas — *i.e.*, the *terms* of the contract that were in effect on November 9, 1978.

Perhaps the most reliable indicator of the way that Section 105(b)(1)(A) should be read is the inconsistency created when the Kansas court's reading is examined in light of the rest of Section 105. *First*, when Congress wanted to adopt the "price on November 9, 1978," as a variable for setting the upper limit of the maximum lawful price, it did so in express terms in Subsection (b)(2) for intrastate gas that was being sold for *more* than the Section 102 new gas price at the passage of the NGPA by dropping the "under the terms of the existing contract" language which it has used in Section 105(b)(1)(A):

> (b)(2) *Contract price exceeding new gas ceiling price on November 9, 1978* — In the case of any natural gas described in subsection (a) of this section for which the contract price applicable on November 9, 1978, exceeds the maximum lawful price, per million Btu's computed for such date under section 3312 of this title (relating to

new natural gas), the maximum lawful price under this section shall be the higher of —

(A) the maximum lawful price, per million Btu's computed for such month under section 3312 of this title; or

(B)(i) *the contract price on November 9, 1978,* in the case of November, 1978; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

[15 U.S.C. § 3315(b)(2). Emphasis added.]

Second, the Kansas court's interpretation of Subsection (b)(1) would inexplicably afford intrastate producers that were selling for a price below the new gas price at the passage of the NGPA worse treatment than those producers that were selling for a price in excess of the new gas price at the Act's passage. As was shown above, under the Kansas court's reading of Subsection (b)(1), producers that were selling below the new gas price on November 9, 1978, would be subject to a price freeze during the six-year term of the NGPA. Application of Section 105(b)(2) to producers that were selling intrastate gas at a price in excess of the new gas price on November 9, 1978, permits a contrary result. Such producers would be entitled to collect their contract price above the Section 102 price until statutorily prescribed monthly adjustments to the Section 102 price catch up with that price and exceed the November 9, 1978, contract price. Those producers would then be entitled to start collecting the higher Section 102 price.

Obviously Congress did not intend to reward the producer covered by Subsection (b)(2) of Section 105 with regularly increasing prices during the term of the NGPA and to penalize the producer covered by Subsection (b)(1) by freezing its price — yet that is precisely the result of the erroneous interpretation of the NGPA by the Kansas court.

III. The Kansas Court's Interpretation Is Contrary to the Legislative History of Section 105.

The legislative history of Section 105 clearly reveals that Subsection (b)(1) was not intended to be read to pick "the contract price" that was in effect on November 9, 1978, as the NGPA maximum lawful price for affected intrastate producers for the duration of the Act. Petitioner has identified the background statements, including that of the Joint Committee on Conference, which evidence the Congressional intent that: "[T]he price under the contract may escalate *through the operation of both fixed price escalator clauses and indefinite price escalator clauses in existence as of the date of enactment*, but the price may not exceed the new gas price (Section 102)." [H. R. Rep. 95-1752, 95th Cong. 2nd Sess. 82 (1978). Emphasis supplied.] *Amici* would emphasize the Kansas court's violation of that intent by its interpretation of Section 105(b)(1) in a manner that negates most standard price adjustment clauses.

IV. The Kansas Court's Interpretation of NGPA Section 105 Is Inconsistent with that Adopted by Other Kansas Governmental Authorities.

Every governmental authority (except the Kansas Supreme Court) that has examined NGPA Section 105(b)(1) has determined that there is nothing in the section that ties the maximum lawful price to the exact price that was in effect on November 9, 1978, and, either expressly or by necessary implication, has concluded that the reference to that date is merely a cut-off for the consideration of amendments to affected contracts. Petitioner Mesa has described the Federal Energy Regulatory Commission's interpretation of Section 105(b)(1) to that effect and the similar interpretation of the Fifth Circuit Court of Appeals in *Pennzoil Company v. Federal Energy Regulatory Commission*, 645 F.2d 360 (5th Cir. 1981), *petition for certiorari*, filed August 18, 1981, No. 81-340, U.S.L.W. 33133 (1981). *Amici* invite the Court's attention to the fact that the Kansas Legislature and the Kansas Corpora-

tion Commission have tacitly and expressly acknowledged and adopted the same conclusion.

In May of 1979, the Kansas Legislature responded to the passage of the NGPA by adopting the Kansas Natural Gas Price Protection Act. [K.S.A. §§ 55-1401, *et seq.* (Supp. 1980).] That act limits NGPA triggering of indefinite price escalator clauses for the six year term of the NGPA, permitting them to operate only up to the NGPA Section 109 "other gas" price. [K.S.A. §§ 55-1404 - 1405 (Supp. 1980).] If the Kansas Supreme Court's interpretation that the maximum lawful price for intrastate producers such as Mesa and *amici* is "the price" that was in effect on November 9, 1978 (as shown hereinbefore because of the nature of standard price adjustment mechanisms, "the price" means there could be no escalation in most instances), there was no reason for the passage of the Kansas Natural Gas Price Protection Act.

In January of 1981, the Kansas Power and Light Company, respondent herein, applied to the Kansas Corporation Commission for an order directing it to perform in a particular way under certain contracts containing indefinite price escalator clauses and raising controversies over their interpretation, or, in the alternative, to issue rules and regulations to implement and enforce the Kansas Natural Gas Price Protection Act. One of the issues raised by the Kansas Power and Light Company was whether, under the terms of standard price redetermination clauses and the strictures of NGPA Section 105, producers are entitled to collect a monthly increasing price as the relevant NGPA ceiling is adjusted upward monthly. The Corporation Commission declined to issue the requested order and rules as premature. The Commission did reach the following conclusion, however:

> We do find, however, that nothing contained in the Price Protection Act [Kansas] prohibits the payment of a monthly adjusted price under an indefinite price escalation clause. The Act recognizes that FERC will be calculating its various ceiling prices on a monthly basis and, in our opinion, contemplates a possible monthly escala-

tion in the contract price of gas under Sections 1405 and 1406 of the Act. [Kansas Corporation Commission, Docket No. 126,236-U, p. 16; pertinent portions of the Commission Docket are attached hereto as Appendix "C."]

The Kansas Corporation Commission's reading of the Kansas Natural Gas Price Protection Act *in pari materia* with the NGPA is clearly at odds with the Kansas Supreme Court's reading of Section 105(b)(1) herein. There would be no issue of monthly escalations if the price in effect on November 9, 1978, was the maximum lawful price for the terms of the NGPA.

SUMMARY OF ARGUMENT

The Kansas Supreme Court's reading of NGPA Section 105(b)(1) has serious adverse implications for numerous intrastate producers that sell natural gas under contracts containing a variety of standard price adjustment mechanisms that were not at issue below. Under the Kansas court's interpretation, producers that were selling at a price below the NGPA Section 102 new gas price on November 9, 1978, have those prices frozen at that level for the six-year term of the NGPA thereby abrogating their contractual price adjustment clauses. This reading of the NGPA is inconsistent with the language of Section 105 in that it fails to give meaning to all of the terms in Subsection (b)(1) and creates the anomalous result that intrastate producers that were selling below the Section 102 new gas price on November 9, 1978, are penalized by a price freeze, while producers that were selling at a price *above* the Section 102 price at that time are rewarded with the continuing ability to rely on their contractual price adjustment mechanisms to increase the price that they receive for their gas. The Kansas court's reading of NGPA Section 105 is also inconsistent with the reading given to it by every governmental body that has given it consideration, including the United States Court of Appeals for the Fifth Circuit, the Federal Energy Regulatory Commission, the Kansas Legislature, and the Kansas Corporation Commission.

CONCLUSION

For each of the reasons set forth above, *amici* urge that, in the interest of providing a proper analysis of the NGPA, the Petition for a Writ of Certiorari be granted herein.

Respectfully submitted,

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APPENDIX A

GAS PURCHASE CONTRACT

NORTHERN NATURAL GAS COMPANY
Operating As
PEOPLES NATURAL GAS DIVISION
(Western Region)
Buyer

and

McCOY PETROLEUM CO., ET AL.
Seller

ARTICLE XII

Price

A. Subject to all of the terms and conditions of this Gas Purchase Contract, the price per MCF to be paid by Buyer to Seller for all gas delivered to Buyer hereunder, or which Buyer is obligated to pay for, whether taken or not, shall be as follows:

(a) For the period commencing with the initial delivery hereunder and continuing thereafter until January 1, 1975 . . . 40.0¢.

(b) Commencing January 2, 1975, and extending through January 1, 1976, and for each succeeding one year period thereafter, the price will be increased one cent (1.0¢) over the contract price for the preceding price period.

(c) Six (6) months prior to the end of the one year period in the twentieth contract year the price shall be negotiated by the parties hereto.

B. Any other provision in this Agreement to the contrary notwithstanding, if the Federal Power Commission or any other successor governmental authority having regulatory jurisdiction over wellhead sales of natural gas for resale in interstate commerce shall at any time hereafter prescribe or

approve for the area in which the dedicated acres are situated a just and reasonable rate for the wellhead sale of natural gas of any vintage which is higher than the total price specified in Article VII and XII and which is applicable to gas of similar quality and on comparable terms and conditions to those herein specified, then Seller may give Buyer written notice thereof and when such notice is given the total price specified in Articles VII and XII shall be automatically increased to equal such higher just and reasonable rate effective as of the date such notice is given or the date such higher rate is prescribed; provided, however, that nothing in this section shall deny to Buyer the right to intervene in any area rate proceeding to oppose the ordering or adoption of any such higher just and reasonable rate.

C. It is further agreed between Buyer and Seller that at any time during the term of this Contract, should Buyer contract and pay a higher price for wellhead gas produced from formations shallower than the top of the Viola formation in Harper, Rice, Reno, McPherson, Harvey, Kingman, Barber, or Sedgwick Counties, Kansas, then Buyer agrees during such time as such higher price is being paid by Buyer to other parties, to pay Seller such higher price for the gas delivered to Buyer by Seller.

APPENDIX B

GAS PURCHASE CONTRACT

This Gas Purchase Contract, executed this 26th day of September, 1975, by and between Petroleum, Inc., a Kansas corporation, of Wichita, Kansas, (hereinafter referred to as "SELLER"), and The Kansas Power and Light Company, a Kansas corporation with offices at Topeka, Kansas, (hereafter referred to as "BUYER").

. . . .

7.1 SELLER shall have the option to cause the price being paid for its gas by Buyer to be redetermined every two years, beginning in 1977. . . .

7.2 Within the same one hundred twenty (120) days following SELLER'S request for a price redetermination, the parties shall mutually redetermine the price by considering three (3) contracts under which the highest prices are actually being paid for flowing gas ninety (90) days prior to the date the redetermined price is to be effective. The contracts to be considered shall, (a) have a primary term of one (1) or more years, (b) be for gas produced in Kansas, (c) be for gas purchased by an interstate or intrastate company selling or using an average daily volume of 5,000 MCF or more of gas for the twelve (12) month period ending ninety (90) days prior to the date the redetermined price is to be effective, (d) not be for the purchase of Spivey-Grabs Field gas by BUYER under Contracts dated in 1975, (e) not include more than one contract of any one purchaser in any one field, and (f) not be for a price then subject to regulatory suspense or refunds. In determining the "highest prices" being paid, and as they may apply to a fair market price under this gas contract, BUYER and SELLER shall make valid adjustments in pricing considerations, including but not limited to the heating value of the gas, and costs of gathering, compression and processing rights.

After the BUYER and SELLER have decided on the three contracts and appropriate prices to be used from each one for this redetermination, the weighted average price per MCF being paid under the three contracts shall be calculated. This price shall become the redetermined price to be paid by BUYER to SELLER.

APPENDIX C

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS

Before Commissioners: Richard C. (Pete) Loux, Chairman
Jane T. Roy
Phillip R. Dick

In the Matter of the Petition of The Kansas Power and Light Company for Implementation and Enforcement of the Provisions of the Kansas Natural Gas Price Protection Act.	)))))	Docket No. 126,236-U

ORDER

NOW, on this 12th day of May, 1981, this matter comes on for decision by the State Corporation Commission of the State of Kansas (Commission) upon the petition of Kansas Power and Light Company for implementation and enforcement of the provisions of the Kansas Natural Gas Price Protection Act.

After considering the pleadings, testimony, exhibits, and its own files and records, the Commission finds and concludes as follows:

. . . .

Both sections 1405 and 1406 of the Price Protection Act contemplate and permit the operation of indefinite price escalator clauses ". . . in accordance with their terms . . ." to the extent that the price payable does not exceed the maximum price allowed by the corresponding category ceiling imposed and adjusted monthly by the Federal Energy Regulatory Commission. Both the NGPA and PPA expressly recognize that the "ceiling prices" are subject to monthly inflation adjustments. Whether KP&L is legally obligated, in any instance, to pay its suppliers the monthly adjusted ceiling price for natural gas sold under contracts subject to the Act or whether it may pay an "adjusted" or redetermined price, to be established at a time prescribed by their contract, for the period of time till

their contract requires another price redetermination, is simply beyond the focus of this proceeding and without the jurisdiction of this Commission. We do find, however, that nothing contained in the Price Protection Act prohibits the payment of a monthly adjusted price under an indefinite price escalation clause. The Act recognizes that FERC will be calculating its various ceiling prices on a monthly basis and, in our opinion, contemplates a possible monthly escalation in the contract price of gas under Sections 1405 and 1406 of the Act. Nothing in the Act, however, would preclude a contrary interpretation in accordance with the particular terms contained in a specific indefinite price escalator clause or as established by competent evidence of the intent of the contracting parties. Whether in the final analysis the monthly adjusted categorical ceiling price should legally be paid and may be collected pursuant to the terms of a redetermination clause which falls within the statutory definition of an indefinite price escalator clause in Section 1402(c) of the Act would entirely depend on the contractual language employed by the parties and their contractual intent. Such a determination is simply a matter to be resolved between the parties to the contract or, failing that, in the appropriate court according to the Kansas law.

Amicus Brief

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FILED
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ALEXANDER L. STEVAS,
CLERK

No. 81-711

In the Supreme Court of the United States

OCTOBER TERM, 1981

MESA PETROLEUM CO., PETITIONER

v.

KANSAS POWER AND LIGHT COMPANY, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Whether the state court's construction of Section 105(b)(1) of the Natural Gas Policy Act of 1978, which regulates the prices of natural gas sold by producers intrastate, is consistent with Congress' intent that the terms of price escalation clauses in intrastate sales contracts should govern within specific ceiling limitations.

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BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Title I of the Natural Gas Policy Act of 1978 (NGPA) (15 U.S.C. (Supp. IV) 3301 *et seq.*) establishes an intricate set of controls on the wellhead price of various categories of natural gas. A major purpose of that title is to remedy serious economic distortions perceived by Congress to have resulted from regulation of producers of natural gas under the Natural Gas Act. Section 501 of the NGPA, 15 U.S.C. (Supp. IV) 3411, grants broad authority to the Federal Energy Regulatory Commission to administer the Act and authorizes the Commission to issue such rules as it deems "necessary or appropri-

ate to carry out its functions under this [Act]." Pursuant to this authority, the Commission has issued rules designed to implement the statute. Both the Commission and the United States have a substantial interest in assuring that the provisions of the NGPA are construed in a manner consistent with Congress' intent in enacting that statute.

STATEMENT

1. In *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), this Court held that the Natural Gas Act applied to producer sales of natural gas in interstate commerce. Subsequently, and in large measure as a result of implementation of the *Phillips* decision, the market for natural gas divided into a regulated interstate market and several distinct, unregulated intrastate markets. By the 1970's this division had resulted in higher prices in the intrastate markets and serious shortages in the interstate market. A central purpose of Congress in enacting the NGPA was to eliminate these dual markets and create a single national market where both interstate and intrastate purchasers would have equal access to new gas supplies without substantial price disparity. One of the ways in which Congress chose to achieve this result was to impose limited price regulation on intrastate producer sales of natural gas by enacting maximum lawful prices for such sales.[1]

Section 105 of the NGPA, 15 U.S.C. (Supp. IV) 3315, is a pricing provision that governs intrastate sales of natural gas that were under contract on the

[1] As the term suggests, maximum lawful prices are ceiling prices and must be authorized by the contract between the buyer and seller of the gas before they may be collected. 15 U.S.C. (Supp. IV) 3311(b)(9).

date that the NGPA was enacted. Section 105(b)(1) applies where the contract price on the enactment date was lower than the price Congress established for new gas elsewhere in the statute. Under this section the maximum lawful price for such gas shall be the lower of (1) "the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978 [the date of enactment of the NGPA], as such contract was in effect on such date," or (2) the maximum lawful price for new gas established in Section 102, 15 U.S.C. (Supp. IV) 3312.

2. Petitioner, Mesa Petroleum Company, was under contract to sell gas intrastate to Kansas Power & Light Company on November 9, 1978, when the NGPA was enacted. A dispute thereafter arose between the parties as to whether the sales contracts authorized Mesa to collect the higher new gas price, or limited Mesa to the lower price it was collecting on the date of enactment of the NGPA. Mesa filed suit in state court seeking affirmance of its interpretation.[2]

The contracts provided, *inter alia*, that if the Federal Power Commission or "any successor governmental authority" prescribes a rate for similar gas that is higher than the contract price, then the contract price shall be increased to equal the regulated price (Pet. App. 29a). The contracts also provided

---

[2] Three contracts and three lawsuits were involved; two were consolidated in the Sixteenth Judicial District of Kansas (Pet. App. 9a-24a) and the third was decided by the District Court of Grant County, Kansas (Pet. App. 1a-8a). Both the consolidated cases and the Grant County case were appealed to the Kansas Supreme Court. That court's opinion (Pet. App. 25a-36a) deals with the Grant County case; the consolidated cases were affirmed per curiam (Pet. App. 37a-38a).

that Mesa's price increase shall become effective as of the date of the governmental authority's act in establishing the higher price or the date the higher price becomes effective, whichever is later (*ibid.*).

The Kansas Supreme Court found that the contracts permitted escalation of Mesa's price to the level of congressionally-established prices (Pet. App. 34a). It also found that the terms of the contracts did not permit the escalation to occur until the effective date of the new NGPA prices, which was December 1, 1978 (*id.* at 35a). But the court ruled that price escalation was barred because, in its view, the NGPA freezes the prices for future intrastate sales to the contract price in effect on November 9, 1978. As the court put it (Pet. App. 35a):

> The maximum lawful price under Section 105 (b) (1) was either the price under the terms of the existing contract on November 9, 1978 ($1.92 per mcf), or the maximum price under Section 102 of the N.G.P.Act for the month of December, 1978 ($2.078 per million BTU's), whichever is lower. Clearly the contract price on November 9, 1978, is the lower and remained the maximum lawful price under Section 105 (b) (1).

Accordingly, the court concluded that "[p]rice escalation on December 1, * * * is no escalation at all for the maximum ceiling price can only rise to the lower of the two prices. The contract price on November 9 was the lower * * *" (Pet. App. 36a).

DISCUSSION

While the state court's decision purports to involve only a question of contract interpretation, the decision, in fact, seriously misconstrues a provision of an important federal energy statute of nationwide application. Unless that court's holding is overturned,

the Commission may be frustrated in its efforts to implement the congressional scheme in a uniform and even-handed manner.

1. The error in the decision below is immediately apparent upon examination of the statutory language. The state court concluded that "[p]rice escalation on December 1 * * * is no escalation at all" because the "contract price on November 9 was * * * lower * * * [than the new gas price]." The statute, however, refers not to the contract *price* on November 9, but rather to the "price *under the terms of the existing contract* to which [the] gas was subject" on November 9. 15 U.S.C. (Supp. IV) 3315(b)(1)(A) (emphasis added). Thus, contrary to the interpretation of the Kansas Supreme Court, the statutory phrase does not incorporate the contract *price* as of the date of enactment of the NGPA; it refers, instead, to the contract *terms* that existed on that date. If those contract terms permit escalation of the price to NGPA levels (and the court below found that the contracts at issue did so provide (Pet. App. 34a)), then Congress clearly meant to allow the escalation.

The structure of the NGPA, as well as its legislative history, firmly support this common sense reading of the statutory language. When Congress wished to focus on the contract price, as it did in a companion provision, rather than on the contract's terms, it made its intent known in clear and precise language. Section 105(b)(2), 15 U.S.C. (Supp. IV) 3315(b)(2), the companion provision, applies where the contract price, on the date of enactment, exceeded the price Congress established for new gas. That subsection states that the maximum lawful price for such gas shall be the higher of the new gas price under Section 102 or "(i) the *contract price* on November 9, 1978, in the case of November 1978; and

(ii) in the case of any month thereafter, the maximum lawful price * * * for the preceding month multiplied by the * * * inflation adjustment factor applicable for such month" (emphasis added). Thus, Congress set the maximum price as the contract price on the date of enactment plus inflation adjustments each month, until the new gas price (which would escalate by higher factors each month) reaches the level of the contract price.[3]

Moreover, the Conference Committee Report specifically explains that Section 105(b)(1) was designed to give effect to escalation clauses in contracts, so long as the escalated prices remain within the limits of the new gas price:

> If the contract price in effect on the date of enactment is less than the new gas ceiling price, the maximum lawful price for any subsequent month is the lower of (1) the price under the

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[3] Congressman Dingell explained the distinction between Sections 105(b)(1) and 105(b)(2) (124 Cong. Rec. H13117 (daily ed. Oct. 14, 1978) (emphasis added)):

> The ceiling price mechanism under section 105(b)(1) is based upon "the terms of the existing contract * * * in effect on [date of enactment of the NGPA]." This phrase must be distinguished from the phrase "contract price" used in section 105(b)(2). The latter is date specific, referring to the price paid under the contract for gas deliveries on date of enactment. The phrase "the price under the terms of the * * * contract" used in section 105(b)(1) *refers to the contract schedule of prices or contract mechanism for establishing prices over time.* This schedule or mechanism is given effect with the single limitation that the price so established may not exceed the new gas ceiling price established under section 102. *The contract price terms in effect on date of enactment would then be honored up to the new gas ceiling price.*

> terms of the existing contract in effect on the date of enactment, or (2) the new gas price. Thus, the price under the contract may escalate through the operation of both fixed price escalator clauses and indefinite price escalator clauses in existence as of the date of enactment, but the price may not exceed the new gas price.

H.R. Conf. Rep. No. 95-1752, 95th Cong., 2d Sess. 82 (1978).

The Commission's rule implementing Section 105 (b) (1) of the NGPA repeats the statutory language.[4] In the preamble to the rule, the Commission explicitly stated that price escalation clauses may be given effect within the limits of the new gas price, so long as those clauses were among the terms of the contract on the date of enactment. Order No. 23, Docket No. 79-22, 44 Fed. Reg. 16895 (1979), aff'd in relevant part, *Pennzoil Co.* v. *FERC*, 645 F. 2d 360 (5th Cir. 1981), petition for cert. pending, No. 81-340.[5] The

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[4] The regulation states (18 C.F.R. 271.502(a)):

> * * * the maximum lawful price for natural gas delivered in any month shall be the lower of:
>
> (1) The price for such month under the terms of the existing intrastate contract to which such natural gas was subject on November 9, 1978, as such contract was in effect on November 9, 1978; or
>
> (2) The maximum lawful price per MMBtu for such month specified for new natural gas * * *.

[5] The question raised in the petition for certiorari in *Pennzoil* has no bearing on this case. It involves a different portion of the Commission's order as well as a different regulation. In its petition, Pennzoil argues that the Fifth Circuit erred in not requiring the Commission to adopt a rule that certain price escalation clauses in interstate contracts automatically entitle producers to earn the maximum lawful NGPA price

Commission's regulation at issue here has not been challenged. It therefore is a validly promulgated final rule with the force and effect of law, *Chrysler Corp.* v. *Brown*, 441 U.S. 281, 295-296 (1979); *Batterton* v. *Francis*, 432 U.S. 416, 425 (1977), and is binding on the state courts. *Free* v. *Bland*, 369 U.S. 663 (1962).

2. To be sure, cases that merely involve questions of intrastate contract interpretation should be decided by the state courts. Had the Kansas court in fact construed the contract not to allow the escalation, the Commission would have no interest in this case. But the issue here is not one of contract interpretation. The state court did not disallow a price escalation because the contract did not permit it. Rather, the court disallowed an escalation on the basis of an erroneous interpretation of federal law.

In enacting the NGPA, Congress recognized the benefit of allowing market forces to work through the terms of existing arm's length bargains, so long as the market prices remained within the ceiling limitations established in the Act. The decision below ignores this legislative intention and carries the potential of undermining the pricing scheme established in the NGPA.[6]

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for the category of gas being sold. Here, the state court construed an intrastate contract to permit escalation, but, contrary to the Commission's rule, it held that the NGPA did not permit the escalation. The Fifth Circuit in *Pennzoil* agreed with the Commission's interpretation of the NGPA provision at issue here. *Pennzoil Co.* v. *FERC*, *supra*, 645 F.2d at 374-376.

[6] The court's decision freezing the contract price affects both the price that can be charged for gas under a successor contract (15 U.S.C. (Supp. IV) 3316), and the determination

CONCLUSION

The petition for a writ of certiorari should be granted and the judgment of the Supreme Court of Kansas should be reversed summarily.

Respectfully submitted.

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whether the gas will be deregulated. 15 U.S.C. (Supp. IV) 3331, 3315(b)(3). It is readily apparent that, if applied to even a fraction of the tens of thousands of intrastate contracts existing on the date of enactment of the NGPA, this decision would seriously disable Congress' program.

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